

ECONOMY AND FINANCE

DCFTA OPPORTUNITIES IN THE CONTEXT OF THE PANDEMIC CRISIS

How DCFTA can cushion shocks
and strengthen resilience

Vadim Gumene

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The COVID-19 pandemic has affected the economic performance of Republic of Moldova. In the first nine months of 2020, the exports of goods fell by 13.4 per cent y-o-y. At the same time, the exports to the EU have contracted by around 10.1 per cent during the reference period.



The exports to the EU are far from reaching the full potential of the DCFTA. It is estimated that the current export potential in the EU is about 41 per cent for agri-food products and 48 per cent for non-agricultural products.



The full use of the export potential will be possible with the consolidation of the efforts of both the producers, by satisfying the conditions for market penetration, and the authorities, by ensuring the necessary regulatory framework.

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CONTEXT

In 2020, the world economy, which was already affected by the economic and geopolitical tensions between the major global players, was shaken by the COVID-19 pandemic. This has also had implications for the economic performance of the Republic of Moldova. Thus, the latest statistics on foreign trade of Moldovan goods reveal a negative effect of the pandemic, including on the trade flows with the European Union (EU). These circumstances have fuelled discussions about the usefulness of the Deep and Comprehensive Free Trade Area (DCFTA) and, in particular, whether this trade regime can help absorb the shock caused by the pandemic and increase the country's exports.

In fact, the Moldovan exports to this destination are considered to be far from reaching their full potential given the opportunities offered by the DCFTA. Thus, it is appropriate to assess the current export potential of the Republic of Moldova to the EU. To meet this challenge, based on a recognized methodology, we have analysed, at the level of groups of goods, which of them have a high export potential that has not been fully utilised so far within the DCFTA.

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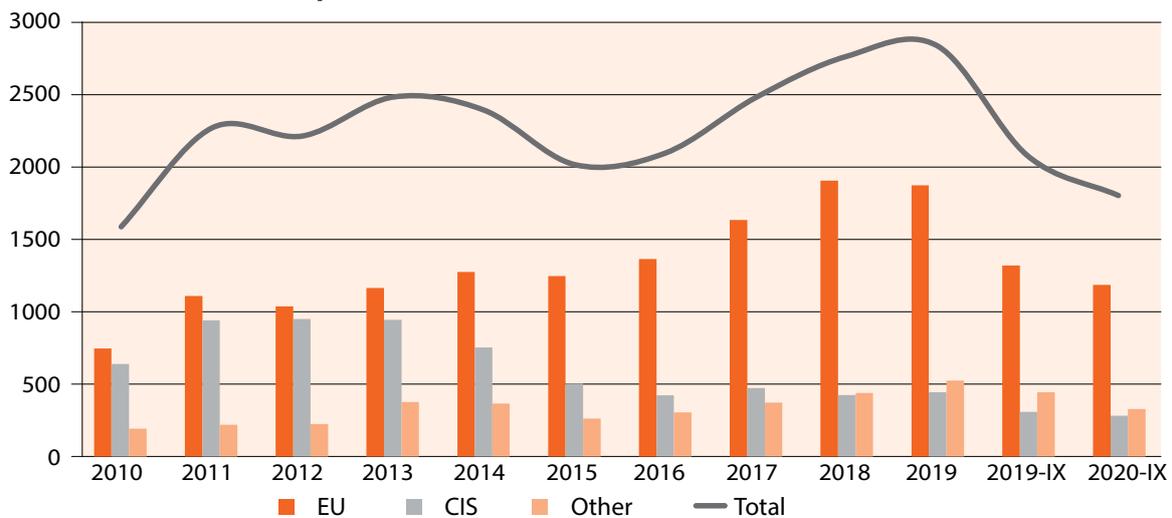
HOW THE MOLDOVAN FOREIGN TRADE WAS AFFECTED BY THE PANDEMIC

The trade flows have suffered as a result of the shocks of 2020. While in 2019 the total exports reached a historical maximum of USD 2.8 billion, in the first 9 months of 2020, they have registered a decrease by 13.4 per cent y-o-y, reductions of exports being registered for all groups of countries (Figure 1). Similarly, the imports have showed a negative evolution, reaching a value of USD 3.8 billion, which is by 10.3 per cent

less y-o-y. Thus, the given developments have determined the accumulation in the first 9 months of 2020 of a trade balance deficit in the amount of USD 2.1 billion, being in decline by 8 per cent y-o-y. On the other hand, the coverage of imports with exports has decreased slightly, accounting in the reference period for 45.8 per cent, compared to 47.4 per cent in the same period of the previous year.

Figure 1.

Evolution of Moldovan exports, mln USD



Source: Expert-Grup calculations based on the NBS data

Following increases in previous years, the exports to the EU fell in 2020 in the context of the pandemic. The exports of Moldovan goods to the European Union have increased from 2015 to 2018, while in 2019 they have reduced slightly (-1.7 per cent compared to 2018), amounting to USD 1.8 billion. The same trend has been maintained in the first 9 months of 2020, with a decrease by 10.1 per cent y-o-y, amounting to USD 1.2 billion. At the same time, they have continued to dominate, with a share of 66 per cent in total exports (63.6 per cent in 2019).

The exports to the CIS have declined at a slower pace as a result of boosting the apple exports. In the first nine months of 2020, the CIS countries have consolidated their position in the country's exports with a share of 15.7 per cent (in 2019 -

14.9 per cent), which corresponds to a value of USD 275 million (-8.9 per cent). This more moderate decline has been possible mainly due to the increase in the fruit exports.

The declines in the exports to other markets (other than the EU and the CIS) have been most dramatic. In the first 9 months of 2020, the exports to other countries of the world (other than the EU and the CIS) have amounted to about USD 321 million, being the largest decrease, by as much as 26.2 per cent y-o-y, which has led to a reduction in the share of total exports of up to 18.3 per cent (in 2019 - 21.5 per cent), but still exceeding the share of the CIS countries in total exports. This decrease has been due to the 23 per cent reduction in the exports to Turkey as a result of the significant drop in the exports of sunflower seeds in the context of the poor harvest this year.

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CHARACTERISTICS OF THE MOLDOVAN EXPORTS TO THE EUROPEAN UNION AFTER THE DCFTA

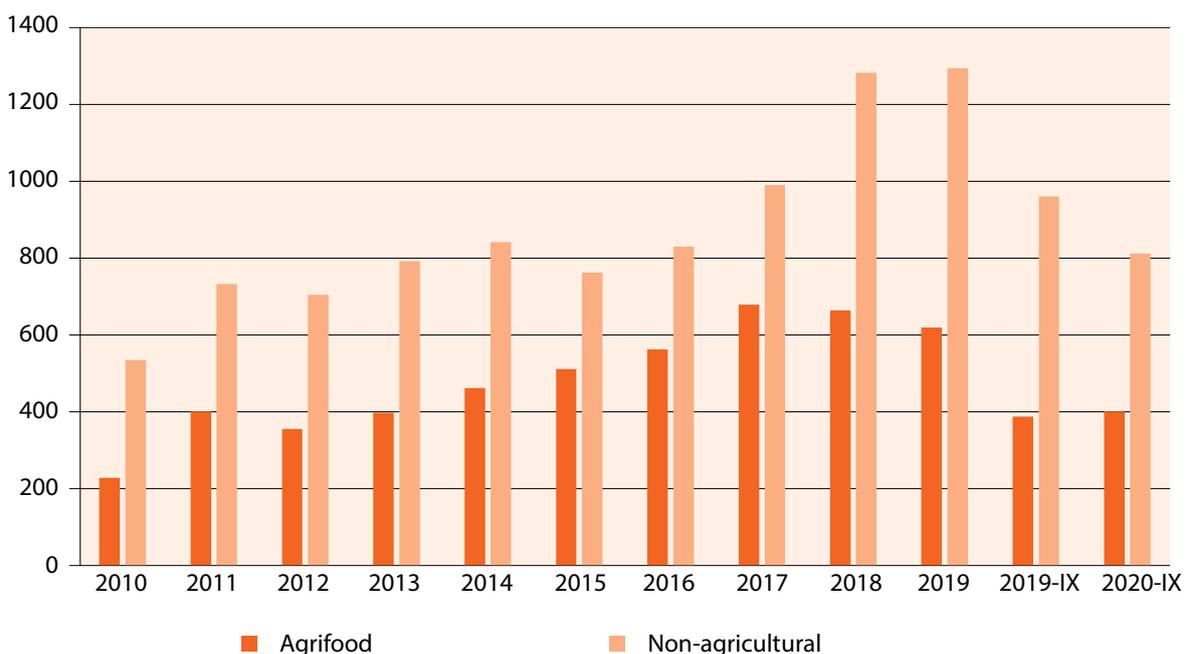
Before assessing the untapped export potential to the EU, it is pertinent to conduct a more detailed analysis of exports to this destination in order to understand the existing general trends, especially after the signing of the DCFTA.

The dynamic of exports of non-agricultural products has registered a positive trend even before the DCFTA. The export of non-agricultural products has meanwhile consolidated in the structure of total exports to the EU, reaching about 70 per cent of total exports to the EU and registering in 2019 a record value of USD 1.24 billion. However, in the first nine months of 2020, they have decreased dramatically, by about 15.6 per cent y-o-y. This development has been determined exclusively by the demand on the EU market, especially for the products of the Lohn industry. In particular, in the context

of the existing pandemic, the automotive industry has registered a substantial cooling both in the EU and globally, which has directly affected the assembly of automotive components (wiring) in the Republic of Moldova.

Exports of agricultural products have been influenced by the situation on the EU market. In the first years after the signing of the DCFTA, the export of agri-food products has been influenced by the improvement of the trade regime, which has determined the increase of exports (cereals, wines, fruits). Subsequently (in 2018-2019), the decrease in exports has been determined either by the oversaturation of the EU market (in the case of walnuts) or by the reduction of prices on the EU market (in the case of cereals and oilseeds), which has led to a reorientation towards other markets (e.g. Turkey).

Figure 2.
Evolution of Moldovan exports to the EU, mln USD



Source: Expert-Grup calculations based on the NBS data

Thus, the exports of these products to the EU amounted to USD 592 million in 2019. Even in this situation, they account for about 50 per cent of the country's total agri-food exports. Surprisingly, in the first nine months of 2020, the exports of agri-food products have registered a slight boost y-o-y, by + 3.5 per cent (see details below).

Excessive concentration is a characteristic of the exports to the EU market. In general, the exports to the EU are characterized by an excessive concentration in terms of diversity of exported products (over 70 per cent of total exports to the EU market is represented by only 7 categories of goods: electrical circuits, textiles, oilseeds, seat parts, cereals, fruits and wine). At the same time, it should be noted that most of these exports have been made under an inward processing regime (at the order and with the use of own raw material),

which implies a rather small added value. All this indicates the urgent need to diversify the portfolio of exported goods, with emphasis on those with a higher added value.

The same is true of exports to the EU in geographic profile. Thus, despite the progressive integration of Moldovan exports into the European trading system, with increased exports to this market, there cannot be ignored the excessive concentration in geographic profile, where about 70 per cent of total exports to the EU are directed to only four member states (Romania, Italy, Germany and Poland). Practically, throughout the period after the signing of the DCFTA, the share between countries has not changed much, Romania having the main role, with a share of around 40 per cent that varies from year to year. Such a situation involves increased risks related to the aggregate demand in these markets.

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HOW THE EXPORTS OF AGRI-FOOD PRODUCTS TO THE EU HAVE EVOLVED

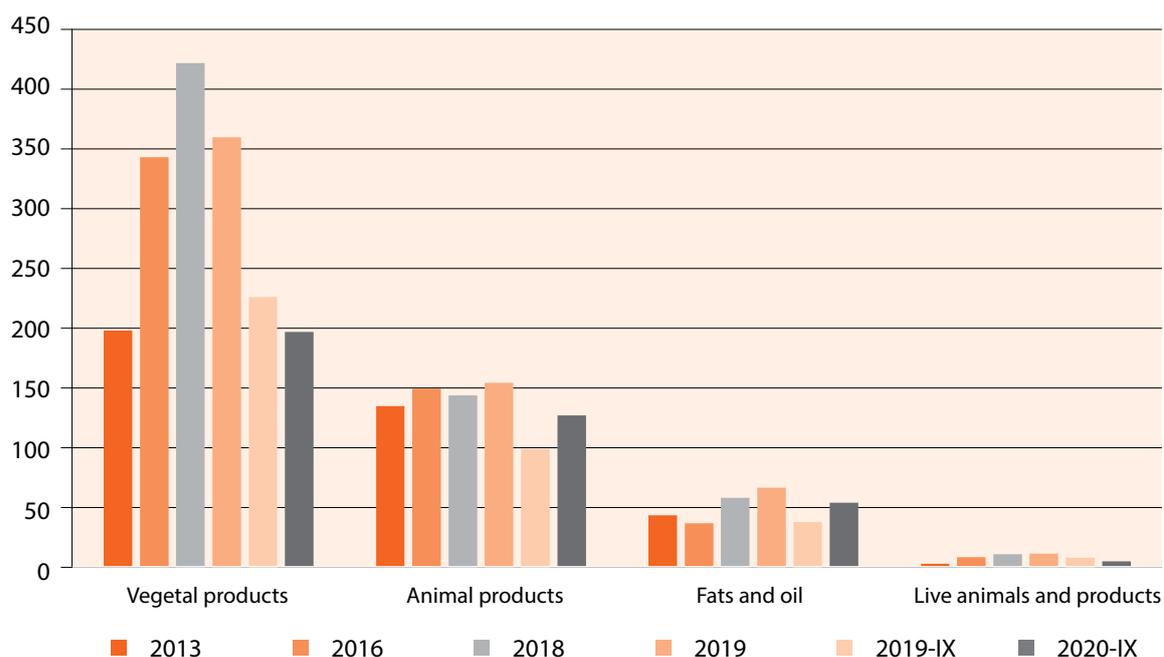
Traditionally, the agri-food products are of increasing interest to domestic exporters, but the range of these exports is rather limited.

Vegetable products with low added value dominate the agri-food exports. During the period after the DCFTA signing, this category accounted for about 60 per cent of total agri-food exports, reaching the figure of USD 359.9 million in 2019. While in the first period after the DCFTA signing, an ascending dynamic could be observed, including due to the increase in the exports subject to quota, in 2019, there was a decrease due to the reduction of exports of cereals by 30 per cent and oilseeds -by 6 per cent (along with the reorientation to other markets, especially Turkey). The same trend has been maintained in the first nine months of 2020, with lower ex-

ports of 12.8 per cent y-o-y, the main reason being the same, even a bigger reduction in grain exports. Also of major importance are the walnut exports, which have expanded in the period immediately after the signing of the DCFTA, although in 2019 there was a substantial reduction (in fact, the decrease was specifically related to the re-export of walnuts, which has been introduced for shelling in the lohn regime). At the same time, we cannot speak of a major extension of fruit exports, they being registered for limited categories, such as grapes and plums, for which tariff quotas are provided (only for these categories of products the tariff quotas being fully utilised).

Agri-food exports with higher added value have been more limited. Unfortunately, there has not been an expansion of exports with higher added value, such as food, which

Figure 3.
Export of agri-food products to the EU, mln USD



Source: Expert-Grup calculations based on the NBS data

amounted to USD 154.4 million in 2019 (7.4 per cent more than in 2018). At the same time, it should not be neglected the substantial increase in exports of these products during the first nine months of 2020 of about + 28.3 per cent y-o-y. This category has been dominated by the export of alcoholic beverages which has practically increased throughout the period after the DCFTA, which registered maximum values in the last year. Also, significant exports of fruit preparations, namely juices, have been registered in the last year, while the export of confectionery has remained more or less stable throughout the period. The sugar exports have been strictly dependent on the pricing policies of European transnational companies operating both in the EU and on the Moldovan market. Moreover, the exports of these product categories, so far modest, indicate an untapped potential (see details below).

The massive exports of oilseeds have affected the export of oil. Unfortunately, the increase in the export of oilseeds, in particular of sunflower seeds, has had a negative effect on another category of exports, namely oil exports. Thus, there were significant decreases of up to 50 per cent in the first years of the DCFTA, although, subsequently, there was a recovery of these deliveries, amounting in 2019 to USD 67 million. Moreover, in the first nine months of 2020, they reached higher values +42.1 per cent y-o-y.

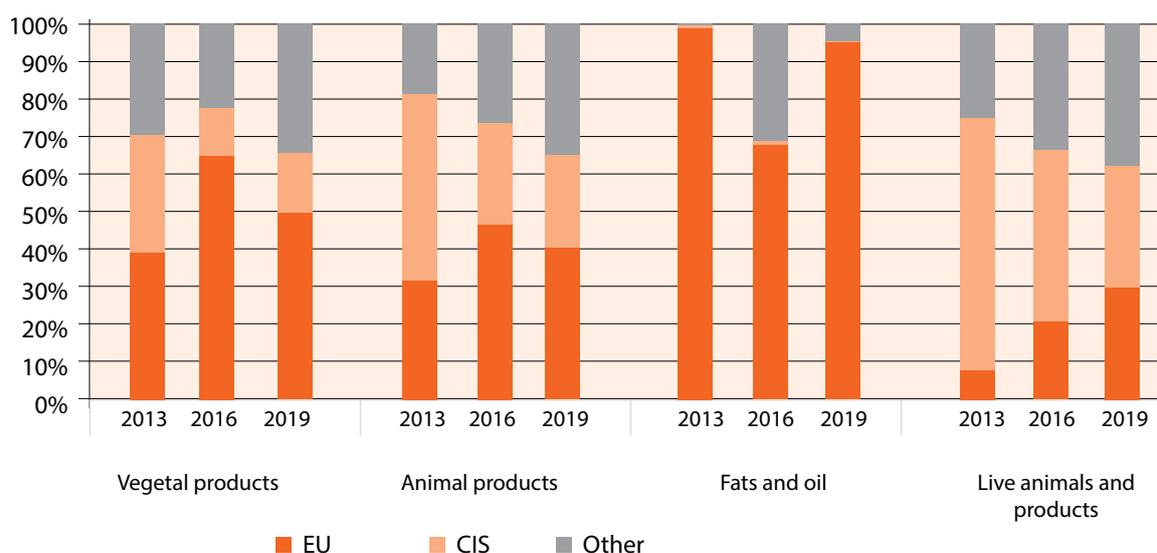
The exports of animal products remain the biggest challenge. The most insignificant exports to the EU were those of live animals and animal products, in fact, a situation that can be explained by the difficult status of these exports to

this destination. Existing exports are almost entirely represented by bee honey exports, which in 2019 amounted to USD 11.2 million and in the first nine months of 2020, they have decreased by 37.5 per cent y-o-y. In fact, exports of such products are also quite modest to destinations other than the EU, which indicates significant shortcomings in competitiveness.

For some agri-food products, the DCFTA has stimulated the growth and reorientation of exports from the CIS to the EU. A reorientation of exports from the CIS countries to the EU can be observed, due, on the one hand, to the restrictions imposed by the Russian Federation and, on the other hand, to the new opportunities offered by the DCFTA or by more attractive prices in other markets. Thus, we could say that the most accentuated migrations of exports, in absolute terms, took place in the case of vegetable products (sunflower seeds, cereals and fruits), food products (alcoholic beverages, fruit preparations), but also products of animal origin (honey).

It should be mentioned that the increases were mainly for the products that were subject to a change in tariff treatment under the new DCFTA trade regime compared to the previous Autonomous Trade Preferences (ATP) regime, together with the allocation/ replacement of preferential tariff quotas, or their cancellation (e.g. in the case of grape wine). At the same time, for the most part, these quotas remain untapped, either due to the impossibility of meeting the conditions for penetration of the given market, or due to the banal lack of production capacity.

Figure 4.
Evolution of agri-food exports by group of countries, per cent



Source: Expert-Grup calculations based on the NBS data

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HOW THE EXPORT OF NON-AGRICULTURAL PRODUCTS TO THE EU HAS EVOLVED

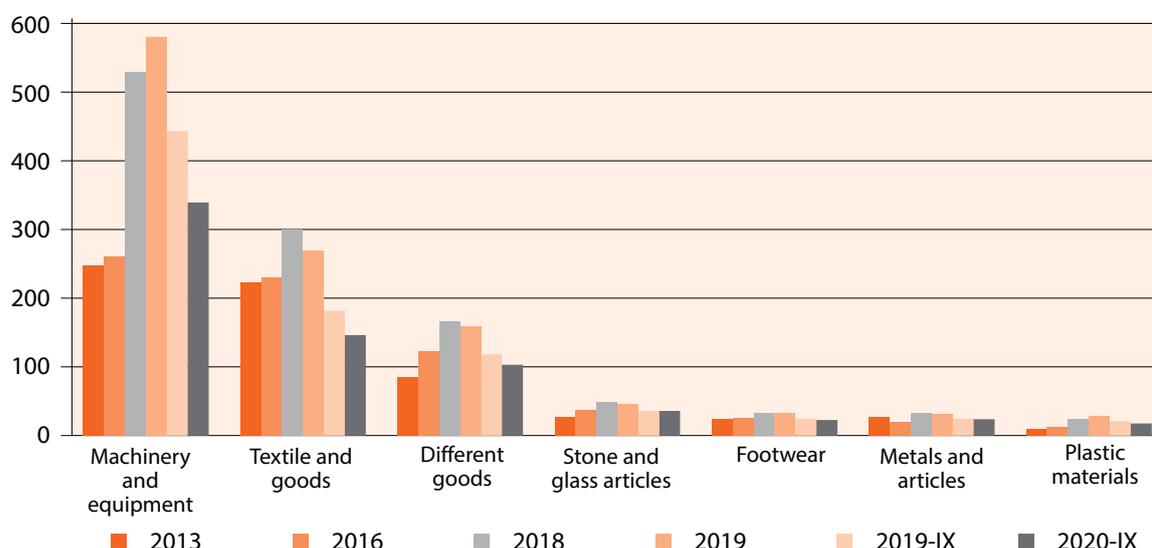
Unfortunately, in the case of non-agricultural product exports, we cannot speak of a full utilisation of the preferential regime within the DCFTA. Although the tariff regime itself for the given products has not changed much, even compared to the previous ATP regime, other aspects of the trade policy have been substantially changed, such as those related to the rules of origin (diagonal cumulation), or TBT. However, there cannot yet be seen a full utilisation of these new possibilities.

The exports of the industries under the Lohn regime have been the most dynamic. As in the case of the agri-food products, the exports of non-agricultural products are highly concentrated, with machinery and appliances occupying the largest share (about 46.6 per cent in 2019), with a value of about USD 576.5 million, although in the first nine months of 2020 they decreased (-23.4 percent) against the background of the global automotive sector contraction. The textile exports are also of great importance, being influenced by the situation of the ordering markets, which occupy a decreasing share from one year to another (in

2019, about 21.7 per cent) and a USD value of 268.2 million, the dynamics also remaining in 2020 (-19.3 per cent y-o-y). Of the various products exported, the most important are those targeting car upholstery, which in 2019 amounted to USD 158 million, decreasing in 2020 (-12.7 per cent) for the reasons stated above, while the other categories of exports being present in much smaller proportions.

The predominance of Lohn goods in the country's exports is not sustainable. In addition to an excessive concentration of the given exports, including at the level of the industrial sector and in terms of geography, another problem is related to the business model in these sectors (automotive and textiles), which in addition to a very low added value, it also implies a precarious sustainability for the country's economy, which can only be a temporary solution. Moreover, the vulnerability of this business model has been demonstrated during 2020, with the sudden decrease in the demand for goods produced in whole or in part under the Lohn regime (e.g. car components, clothing, footwear).

Figure 5. Exports of non-agricultural products to the EU, mln USD



Source: Expert-Grup calculations based on the NBS data (HS Sections)

5

THE EXPORT POTENTIAL OF THE REPUBLIC OF MOLDOVA TO THE EU

Despite the positive dynamic of Moldovan exports to the EU markets, they are far from reaching the full potential of the DCFTA opportunities. Thus, it is reasonable to assess the country's export potential to the EU in relation to the DCFTA. In this regard, we will use the ITC Methodology, where the indicators provided will allow the identification of products with which the Republic of Moldova has already proven to be internationally competitive and which have good prospects for export success. In this way, we will analyse the groups of goods with a high export potential, but which has not been fully utilised so far within the DCFTA.

ITC methodology for assessing export potential*

To help countries identify promising products for their inclusion in the export promotion activities, the International Trade Centre (ITC) has developed a methodology for assessing the export potential. This methodology is based on breaking down a country's potential exports at the product level on a given target market into three factors: supply, demand and ease of trade. Demand and supply are projected into the future based on the GDP and population forecasts, the demand elasticity and the anticipatory tariffs. The estimated value in dollars serves as a benchmark for comparison with real exports and should not be interpreted as a ceiling value.

The Potential Export Indicator (PPI) serves countries that aim at supporting the existing export sectors, with the aim of increasing the exports to existing or new markets. Inspired by a gravitational framework, PPI identifies products with which the exporting country has already proven to be internationally competitive and which have good prospects for export success in a given target market.

* Methodology: http://exportpotential.intracen.org/media/1089/epa-methodology_141216.pdf

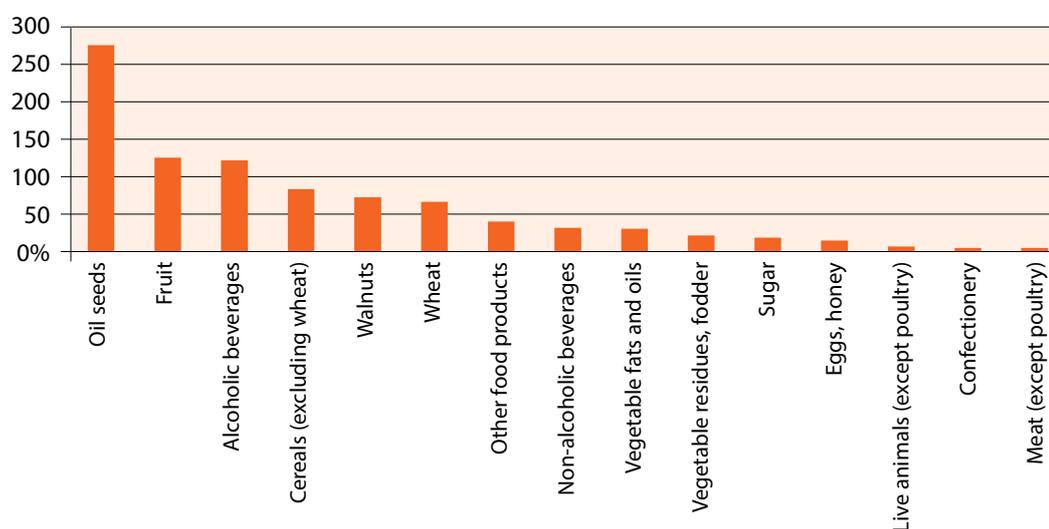
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EXPORT POTENTIAL WITH AGRI-FOOD PRODUCTS

Products already exported to other markets have the greatest export potential. In the case of agri-food products, the oilseeds have the biggest export potential on the EU market, with a value of about USD 270 million. At the same time, fruit, which is subject to tariff quotas under the entry price system, ranks second with a potential of about USD 124 million. However, not all fruits have an increased export potential. For example, only grapes, apples and plums have a higher export potential, while other fruits either have a very low potential or no potential at all. It is natural that the alcoholic beverages

are also found in the top of products with increased export potential, calculated at USD 120 million. The following product categories, which have an export potential of about USD 70-80 million, are cereals (e.g. corn, wheat) as well as walnuts. Importantly, higher value-added products have very high export potential, such as juices (USD 31 million), vegetable fats (USD 29 million) and sugar (USD 18 million). At the same time, export potential, although lower, have the products of animal origin, such as eggs, honey (USD 14 million), live animals and meat, except for poultry, of USD 6 and 4 million respectively.

Figure 6.
Export potential of agri-food products in the EU, mln USD



Source: Developed based on ITC data

The export potential of agri-food products is utilised at only 41 per cent. In order to better understand the extent to which the export potential of agri-food products to the EU is being utilised, we have overlapped the above data with the de facto exports. Thus, we can see that for the analysed products, the export potential was used only at 41 per cent and only a few products have managed to exceed the threshold of 50 per cent (cereals, nuts, oils, confectionery). For two of them the potential

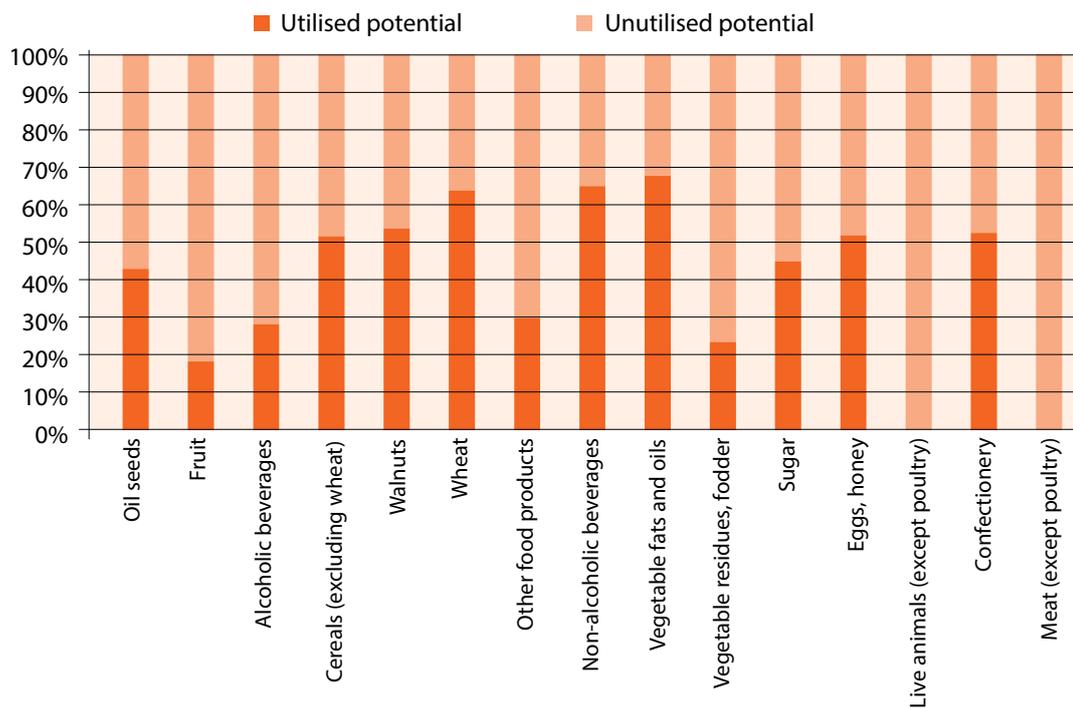
was not utilised at all (live animals and meat). Especially, we can see a very low level of capitalization of the export potential with fruit (18 per cent), and despite the success of the export of alcoholic beverages, their potential is far from being realized (only 28 per cent). At the same time, it is curious that for some traditional products, such as vegetables, there is virtually no export potential at the moment, indicating inefficiencies of the given sector in relation to the EU.

There is a modest level of utilisation of export potential. There is fairly modest level of utilisation of the export potential of agri-food products in the EU, despite existing premises, including those created by the DCFTA (quotas), especially for products that do not require a high degree of processing. On the other hand, special attention should be paid to agri-food products with higher added value and for which there is a real export potential (e.g.

beverages, food, confectionery, etc.). However, ensuring coherence in the processes related to the quality infrastructure (TBT/ SPS) could facilitate the development of these food industries. At the same time, it remains imperative to obtain the status of eligible third country for the export of animal products on this market, in order to be able to utilise the existing potential, although small, for these product categories.

Figure 7.

Level of utilisation of the export potential of agri-food products in the EU, per cent



Source: Developed based on ITC data

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EXPORT POTENTIAL OF NON-AGRICULTURAL PRODUCTS

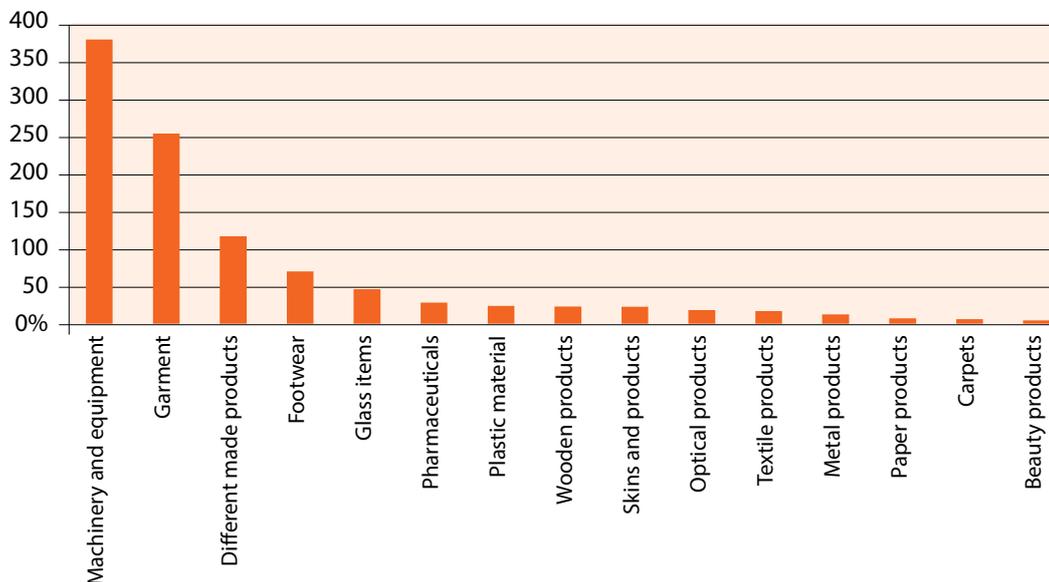
Estimating the export potential of non-agricultural products is more difficult due to the existing business model for most products (lohn). The dominance of non-agricultural exports of several categories of manufactured goods makes it difficult to assess the actual export potential. However, the methodology applied acknowledges that given that the actual exports exceed the potential exports, this may be due to the exceptional performance of exports with limited products in certain markets, neglecting other factors. In this case, the

inward processing (for the automotive and textile industries) is this very factor which distorts the real export potential.

Current exports have the highest calculated export potential. Therefore, the non-agricultural products with a higher export potential remain the ones that still dominate the exports to this destination. In this case, we refer to goods produced under suspension, such as: machinery and equipment, clothing, footwear and car upholstery.

Figure 8.

Export potential of non-agricultural products in the EU, mln USD



Source: Developed based on ITC data

Massive exports of goods produced in lohn mask the real export potential. In the light of the methodological factors mentioned, for some product categories, the current exports exceed the calculated export potential. However, the methodology admits that even in these circumstances the realized potential can be below 100 percent. This happens when the individual exporter-product-market combinations still have unused potential at the disaggregated level,

which is masked by the exceeding potential of other product categories (under exceptional conditions, such as lohn).

The export potential of the selected non-agricultural products remains utilised at only 48 percent. In the case of the a more disaggregated assessment of the export potential of the non-agricultural products, it can be observed that it has been in fact utilised only at the level of 48 percent,

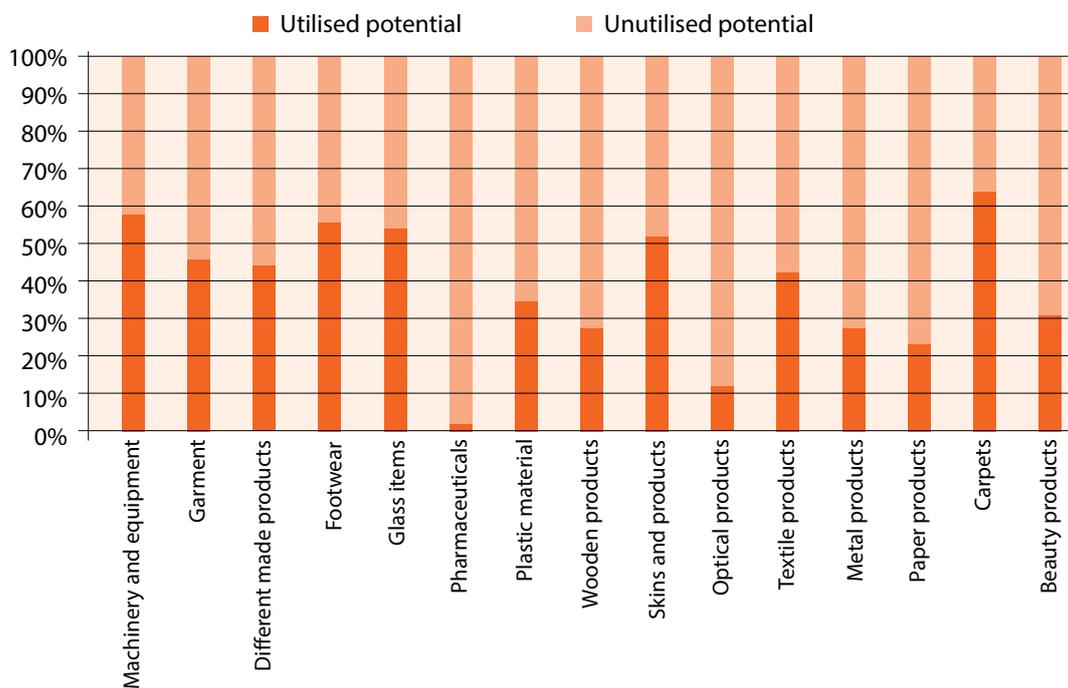
where only a few products managed to exceed the threshold of 50 percent (e.g. electrical equipment, footwear, glassware and carpets), and for another category, the potential has not been realized at all (e.g. pharmaceuticals).

In order to fully utilise the export potential, it is necessary to change the business model (other than Lohn). Although in tariff terms the EU conditions have long allowed for an expansion of non-agricultural exports, this has not happened, the main reason being the excessive focus on the Lohn-based

industries. However, this model is not sustainable, and the DCFTA has created favourable conditions for the creation of its own export capacities. In fact, the new rules of origin offer a unique chance to diversify the raw material base not only within the EU, but also in Turkey, which would breathe new life into the competitiveness of products on the European market. Moreover, the implementation of the new standards taken over from the *acquis communautaire* could facilitate the penetration of the EU market and lead to the utilisation of existing potential.

Figure 9.

Level of utilisation of the export potential of non-agricultural products in the EU, per cent



Source: Developed based on ITC data

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Level of utilisation of the export potential of non-agricultural products in the EU, per cent

ABBREVIATIONS

ATP	Autonomous Trade Preferences
CIS	Commonwealth of Independent States
DCFTA	Deep and Comprehensive Free Trade Area
EU	European Union
HS	Harmonized Commodity Classification System
ITC	International Trade Centre
NBS	National Bureau of Statistics
SPS	Sanitary and Phytosanitary Standards
TBT	Technical Barriers to Trade

ABOUT THE AUTHOR

Vadim Gumene, programme director with Expert-Grup,
vadim@expert-grup.org

IMPRESSUM

Expert-Grup Independent Analytical Center | 45 Bernardazzi st. |
Chisinau | Republic of Moldova
www.expert-grup.org

Friedrich-Ebert-Stiftung Moldova | 111 Bucuresti st | Chisinau |
Republic of Moldova

Responsible:

Juliane Schulte | Representative for Romania and the Republic of
Moldova

Tel.: ++373 22 855832 | Fax: +373 22 855830
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DCFTA OPPORTUNITIES IN THE CONTEXT OF THE PANDEMIC CRISIS HOW DCFTA CAN CUSHION SHOCKS AND STRENGTHEN RESILIENCE



The pandemic has affected the commercial exports of the Republic of Moldova, and in the first nine months of 2020 they registered a decrease by 13.4 per cent y-o-y. This trend has been a characteristic of all groups of countries, including the exports to the EU market, which fell by 10.1 per cent y-o-y, amounting to USD 1.2 billion. These negative developments have fuelled discussions about the usefulness of the DCFTA and, in particular, whether this trade regime can be used to absorb the shock caused by the pandemic and increase the country's exports, in general.



Despite the progressive integration of Moldovan exports into the European trading system, there persists an excessive concentration in geographical terms, with about 70 per cent of total EU exports being directed to only four member states. The same is characteristic in terms of diversity of exported products - over 70 per cent of total exports to the EU is represented by only seven categories of goods. Moreover, most of these exports have been made under the inward processing (lohn) regime, which implies a rather low added value. All this erodes the efficiency of utilizing the export potential offered by this trade regime.



Regardless of the positive trend in the exports to the EU market in recent years, they are still far from reaching the maximum potential offered by the DCFTA. In order to utilise the export potential at a higher level, it is necessary to develop the exports of higher added value for which there is a real potential. At the same time, it is imperative to obtain the status of eligible third country for the export of animal products on this market. It is also of paramount importance to change the business model (outside the lohn regime) by developing own export capacities and using the facilities provided by the DCFTA (e.g. tariffs, new rules of origin, European standards, etc.).

Further information on the topic can be found here:
www.fes-moldova.org