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Prospects for EU-Moldova economic relations

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List of abbreviations

AGEPI	State Agency on Intellectual Property
AGP	Agreement on Government Procurement
ATP	Autonomous Trade Preferences
CA	Current Account
CCI	Chamber of Commerce and Industry
CEFTA	Central European Free Trade Agreement
CIS	Commonwealth of Independent States
CISRM	Chamber of State Registration of the Republic of Moldova
CSP	Country Strategy Paper
EBRD	European Bank for Reconstruction and Development
EC	European Commission
EGPRSP	Economic Growth and Poverty Reduction Strategy Paper
EICC	European Information Correspondence Centre
ENP	European Neighbourhood Policy
ENPAP	European Neighbourhood Policy Action Plan
ENPI	European Neighbourhood and Partnership Instrument
ERDF	European Regional Development Fund
EU	European Union
EUBAM	EU Border Assistance Mission
EUSR	European Union Special Representative
FDI	Foreign Direct Investments
FSAP	Financial Sector Assessment Program
FTA	Free Trade Agreement
GDP	Gross Domestic Product
GNDI	Gross National Disposable Income
GSP	Generalized System of Preferences
IBL	International Bureau of Labour
IFI	International Financial Institution
IMF	International Monetary Fund
JHA	Justice and Home Affairs
MFN	Most Favoured Nation
MIEPO	Moldovan Investment and Export Promotion Organization
MIP	Multi-annual Indicative Programme
MSTQ	Metrology, Standardization, Testing, Quality
MTEF	Medium Term Expenditure Framework
NAPHR	National Action Plan for Human Rights
NBM	National Bank of Moldova

NCU	National Coordinating Unit
NGO	Non-governmental organization
NIP	National Indicative Programme
OIE	Organization for Epizootic Diseases
OSCE	Organization for Security and Co-operation in Europe
PCA	Partnership and Cooperation Agreement
SAPARD	Special Accession Programme for Agricultural and Rural Development
SEE	South Eastern Europe
SME	Small and Medium size Enterprise
SMS	Standardization and Metrology Service
SSDD	Special Standard of Data Dissemination
TACIS	Technical Assistance for CIS
TAIEX	Technical Assistance Information Exchange Office
TRIPS	Trade Related Aspects of Intellectual Property Rights
UNDP	United Nations Development Programme
UNICEF	United Nations Children's Fund
USAID	US Agency for International Development
VAT	Value Added Tax
WTO	World Trade Organisation

Introduction

In recent years, external links of the Republic of Moldova have been determined by the influence of two geopolitical blocks, the Commonwealth of Independent States (CIS) and the European Union (EU). Moldova is currently a member of the CIS, largely as a result of historical economic and political ties.

However, despite the strong ties with the CIS, relations with the EU are becoming increasingly important particularly with regard to the economic situation in the country. Following the 2007 EU enlargement, Moldova will directly border the EU community, as a result of the border with Romania, making strong relations with the EU even more important. Further, there are a large number of inhabitants of Moldova who possess Romanian passports which will necessitate increased Moldova-EU cooperation.

This study analyses the current situation in Moldova and presents scenarios for future economic integration of Moldova with the European Union. It is expected that these findings will be used in the formulation of Moldovan economic policy, particularly while drafting the next framework agreement with the EU.

The report begins with the presentation of recent economic trends in Moldova. The year 2005 was the fifth successive year of high economic growth, marking the country's recovery after a deep and prolonged recession during the 1990s. Chapter 1 analyses the effects of recently proposed and implemented macroeconomic policies, as well as ad iscussion of some of the structural changes that have taken place during the last five years.

Chapter 2 provides a background of EU-Moldova relations. It presents the economic aspects of the Partnership and Cooperation Agreement (PCA), the main document to date regulating relations between the EU and Moldova. This is followed by a discussion of the Moldovan role in the EU Neighbourhood Policy and a description of bilateral trade relations, including Moldovan participation in the Balkan trade integration that will lay the groundwork for increasingly in-depth economic relations with the EU. Additionally, special attention is given to Transnistria and EU involvement in integrating this breakaway region into the Moldovan economy.

As a partner in the EU European Neighbourhood Policy, in early 2005, Moldova signed the Action Plan that aims to bring the country closer to the EU. In fact, this

Action Plan is a precondition for tightening relations between Moldova and the EU. For this reason, the team of researchers decided to conduct an independent assessment of the stages of fulfilment of the economic provisions of the EU-Moldova Action Plan, which is presented in chapter 3. Chapter 4 describes prospects for future EU-Moldova economic relations. First, the author evaluates the bilateral positions of Moldova with respect to various countries, the readiness to integrate with the EU and the expectations of further EU integration. Second, the most feasible stages of integration are presented, which include trade liberalisation, resulting in the implementation of a free trade area, economic integration of Transnistria and fewer restrictions on movement of labour. These steps should be supported by the new financial possibilities that would open under the new European Partnership and Neighbourhood Instrument.

Finally, current attitudes towards the integration with the EU and EU economic principles given by Moldovan economic actors are presented in chapter 5. These are the results of anopinion poll that was conducted among 200 representatives of business, public administration and academics in Moldova in the autumn of 2006. The report concludes with aset of recommendations.

This report was prepared by a team of Polish and Moldovan experts. The authors are grateful for the support and assistance received from the following institutions: the Ministry of the Economy and Trade of the Republic of Moldova, the Ministry of Foreign Affairs and European Integration of the Republic of Moldova, and the Embassy of the Republic of Poland in Chisinau. This report was made possible due to the financial support provided by the Ministry of Foreign Affairs of Poland.

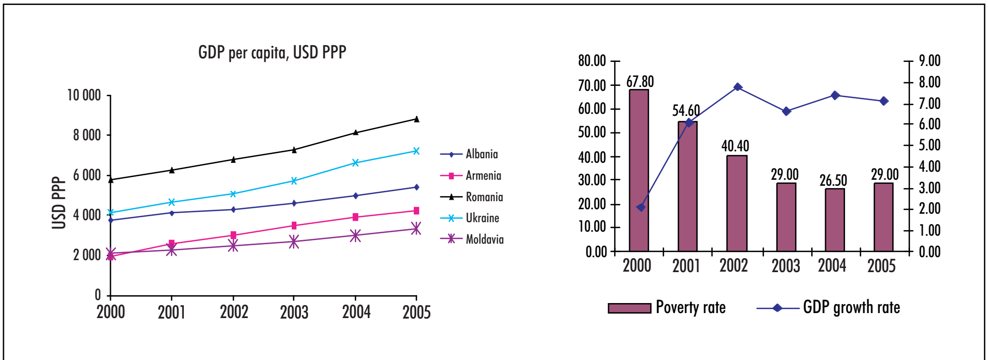
Chapter I.
The Moldovan economy 2002-2005

1.1. Economic growth

Moldova's transition to a market economy in the 1990s was marked by a particularly deep and prolonged recession followed by economic growth beginning in 2000. However, according to official estimates[1], output in 2000 was still less than half of what it had been in 1989, making the situation far from favourable. As a result, by the end of the 1990s, over 70% of Moldovans were poor and nearly 60% were considered extremely poor. GDP per capita was as low as USD 350 and Moldova's social indicators were among the lowest in the region[2].

Much has changed since then. Over the last six years, Moldova's macroeconomic performance has been characterized by a sustained output recovery that had a significant impact on poverty reduction. From 2000-2005, GDP growth exceeded 43%, with GDP growing by an average of 6.9 % per annum and by 2005, GDP per

Figure 1. GDP per capita, GDP growth and poverty, 2000-2005



Source: IMF (World Economic Outlook September 2006

Source: Ministry of Economy and Trade

[1] Excluding shadow economy.

[2] According to the 2006 UNDP Human Development Index, Moldova ranked 114 out of 177 countries, the lowest of all transition countries except Tajikistan (See Human Development Index in Human Development Report 2006, United Nations Development Program, available on-line at www.undp.org).

capita exceeded USD 800 (Table 1). Despite these results, GDP per capita and the average standard of living remain much lower than in the European Union and other countries in Central and Eastern Europe (Figure 1).

Due to strong economic growth, the rate of absolute poverty decreased by over a half during 2000-2005, yet inequality levels remained virtually unchanged, as measured by a Gini coefficient of 0.38. Comparing the level of inequality with other countries in the region, Moldova's high level of inequality is similar to that of Georgia (0.4), Macedonia (0.39) and Russia (0.4). While Romania (0.31), Bulgaria (0.29) and Ukraine (0.28) report slightly lower levels of inequality[3].

While Moldova's growth rates are impressive, most of the transition countries have experienced strong economic growth over this period. Among CIS countries, Moldova's recent growth rates are in line with the regional average (Table 1)[4].

Table 1. Gross Domestic Product, 2000-2005

Indicators	2000	2001	2002	2003	2004	2005
GDP, lei millions	16019.6	19051.6	22555.9	27618.9	32031.8	36755.4
GDP per capita, USD	353	407	459	548	721	812
GDP growth rate, %	102.1	106.1	107.8	106.6	107.4	107.1
CIS average GDP growth rate, %	109.0	106.0	105.1	107.6	107.9	106.2
Poverty rate, % (national poverty line)	67.8	54.6	40.4	29.0	26.5	29.0

Source: National Bureau of Statistics of the Republic of Moldova

According to IMF projections, growth is expected to slow gradually in 2006 and over the medium term, partly in response to higher oil prices and emerging labour shortages. Real GDP is projected to grow by 6% in 2006 and 5 % over the medium term[5].

The export of labour and the resulting inflow of workers' remittances have come to dominate Moldova's economic and social landscape, which is discussed in greater detail in section 1.5. As a consequence of the 1998 regional financial crisis, the inflow of workers' remittances accelerated as an increasing number of Moldovans emigrated in search of higher paying job opportunities abroad. According to the IMF[6], some 571,000 Moldovans, or 39% of the economically active population, are currently working abroad. As a result of increased migration, between 1999 and 2005 officially recorded remittances increased from 14% to nearly 31% of GDP, making Moldova among the most remittance dependent economies in the world.

The rapid increase in workers' remittances has played a positive role in spurring Moldova's economic recovery. Along with the growth in real wages, the large inflow

[3] Data from the World Bank, *World Development Indicators*, accessed on 10 October 2006. Data refer to the year 2003.

[4] Average of the real GDP growth rate in other neighboring countries in the period 2000-2005: Romania-5.1%, Bulgaria-5.0%, Ukraine 7.2%, Russia-6.8%. (See IMF Country Report 06/184, May 2006).

[5] IMF Country Report No.06/184, May 200, available on-line at www.imf.org

[6] IMF Country Report Nr. 05/54, February 2005, available on-line at www.imf.org

of remittances has led to a significant increase in income which, in turn, has fuelled consumption. While the GDP per capita has grown on average by 18% per annum since 2000, Gross National Disposable Income (GNDI) per capita - the income available to domestic residents for consumption including remittances - has grown even faster at 21% per annum[7].

The analysis of the expenditure components of GDP, presented in , illustrates the extent to which the economic recovery in Moldova has been driven primarily by final consumption expenditures.

Table 2. Gross Domestic Product, growth rate 2000-2005

	GROWTH RATE					
	2000	**2001**	**2002**	**2003**	**2004**	**2005**
Total final consumption	117.2	104.4	109.7	115.4	102.0	109.5
Gross capital formation	111.9	105.2	101.1	113.5	110.5	111.0
Net exports	224.6	98.5	109.1	148.8	91.8	118.8
Gross Domestic Product	102.1	106.1	107.8	106.6	107.4	107.1

Source: Ministry of Economy and Trade.

In contrast to consumption, the contribution of investment to current economic recovery has been modest. As a share of GDP, fixed capital formation has remained quite low, averaging less than 19% between 2000-2005, and has been slow to recover from the impact of the regional financial crisis. While investment has been gradually increasing over the last few years, largely as a result of a remittance financed construction boom, gross fixed capital formation still only constituted about 18% of GDP in 2005. Of this, private investment contributed 16% of GDP, while public investment was very low at about 2% of GDP. Even when compared to other transition economies, private investment levels in Moldova are disproportionately low[8].

While strong economic performance in Moldova's main trading partners has encouraged a rapid increase in exports, registering an average annual growth rate of approximately 21% during 2001-2005, the remittance-driven increase in consumption has led to an equally rapid increase in imports, with an average annual growth of 23%

Table 3. Decomposition of Gross Domestic Product, 2000-2005

	2000	**2001**	**2002**	**2003**	**2004**	**2005**
Gross Domestic Product. %	2.1	6.1	7.8	6.6	7.4	7.1
Total Final consumption, %	15.44	4.48	9.78	15.85	2.20	9.88
Gross capital formation, %	2.73	1.25	0.25	2.93	2.42	2.91
Net exports, %	-16.06	0.41	-2.21	-12.16	2.74	-5.71

Source: Ministry of Economy and Trade.

[7] EBRD, Transition Report 2005

[8] IMF Country Report Nr. 05/54, February 2005, available on-line at www.imf.org

over the same period. As a result, negative net exports in Moldova have remained a drag on economic growth (Table 2). Further, annual growth of imports has averaged almost 23% over the past five years, leading the trade deficit to nearly double as a share of GDP reaching 40% of GDP in 2005 (Table 7).

It should also be noted that the market and commodity composition of exports increases the vulnerability of Moldova to external shocks. Nearly 60% of Moldova's exports are in the form of agricultural products, including outputs from the agro-processing industry, and products from the wine and beverage sector. Although trade has been slowly redirected toward the EU, this transformation has been much slower than in other transition countries. As a result, the majority of exports are still bound for CIS members that, at times, has led to trade disputes with the Russian Federation. (see section 1.4)

1.2. Fiscal and financial management

Fiscal policy tightened considerably in the late 1990s and by 2001 large fiscal deficits turned into surpluses. Since 2001, both expenditures and revenues have increased faster than GDP. Simultaneously, the government has maintained a prudent fiscal stance, with the overall cash deficit of the general government averaging only -0.1% of GDP (Table 4).

Table 4. Public finances, 2000-2005

Indicators	2000	2001	2002	2003	2004	2005
Revenue, MDL mil.	4102.4	4324.8	5084.4	6620.5	7521.5	14704.0
Expenditure, MDL mil	4268.8	4325.8	5194.1	6183.4	7390.1	13949.2
Deficit , MDL mil	-166.4	-1.0	-109.7	437.1	131.4	754.8
- in % to GDP	-1.0	0.0	-0.5	1.6	0.4	2.1

Source: National Bank of Moldova.

Although some increase in revenues has come from increases in the collection of profit and personal income taxes, the bulk of the revenue increase is a result of taxation on consumption, primarily through the valued added tax (VAT). The VAT now supplies nearly 50% of the total consolidated budget revenues with over 87% coming from the VAT collected on imports. Corporate and personal income taxes, on the other hand, each supply only about 10% of fiscal revenues. Since 2001, the corporate tax rate has been reduced from 28% to 20% in 2004, down to 18% in 2005 and 15% in 2006. Similarly, personal income taxes have also been reduced, with the highest marginal rate declining from 32% to 25%.

Fiscal pressure has been gradually increasing in recent years as taxes as a share of GDP have increased from 24.6% in 2000 to 31.9% in 2005[9]. An increase in the fiscal burden indicator has been determined by the increase of imports and to a smaller extent by the elimination of inefficiencies in the fiscal administration system.

The budgetary process has been improved due to the implementation of the Medium Term Expenditure Framework (MTEF) and by preparing estimates of the consolidated general government revenues, including state and local government budgets, the social insurance budget and compulsory medical insurance budget, as well as extra budgetary funds.

On the expenditure side, the government has focused spending increases on those programs that were cut dramatically at the end of the 1990s or earlier. Since 2000, spending on health, education and social protection has increased by nearly 6% of GDP.

Debt management

Moldova's debt exposure is primarily directed towards multilateral creditors, in particular, the World Bank, IMF, EBRD, and it is largely on concessional terms; Russia and other Paris Club members also count as significant creditors. In addition, approximately half of government debt is owed to Gazprom, Russia's gas export monopoly, putting Moldova in a particularly precarious position regarding Moldova-Russia relations.

Since 2000, the government has bought back and rescheduled debts owed to a number of commercial and bilateral creditors and has had a portion of its debt forgiven. The government has also resorted to the accumulation of arrears on its external obligations, principally to Gazprom and other bilateral and commercial creditors.

From 2002-2005, the government had been repaying, only about two-thirds of the scheduled debt service obligations on average.

Table 5. Internal and external debt, 2000-2005

Indicators	2000	2001	2002	2003	2004	2005
External debt/GDP, %	133.9	113.5	109.6	97.7	73.1.	68.4
Gross external debt stock, USD mil.	1721.0	1675.0	1816.4	1936.1	1898.0	1996.53
Public external debt services (effective) /Exports (goods &services,%	16.1	15.8	10.7	8.4	10.1	5.7
Debt on imported energy resources, USD mil.	316.4	287.2	301.4	300.0	287.1	288.6
Public Internal debt, MDL mil.	2022.2	2400.5	2821.4	2920.4	3714.1	3787.1

Source: National Bank of Moldova.

[9] National Bureau of Statistics of the Republic of Moldova.

Economic growth, lower interest rates on debt, and the appreciation of the exchange rate relative to the US dollar have helped ease the strain of debt servicing on the budget. From 2001, debt servicing due has fallen by half, while two-thirds of serviced debt has been repaid. These developments, combined with efforts to reduce the total stock of debt, have improved the overall debt outlook for Moldova. Over the period 2000-2005, external public debt has declined in relative terms (as percent of GDP). By the end of 2005, the external public debt had fallen to 68.4% of GDP (Table 5). The international financial organizations remained the main creditors of Moldova holding 41.9% of the total external debt in the form of loans and debt securities. The rapid reduction in Moldova's debt since 2000 has proven that the country is able to attain medium-term fiscal sustainability.

Domestic public debt, largely borrowed from the National Bank, has remained relatively stable since 2000. In 2005, for the first time since independence, the government began repaying the credits received from the National Bank of Moldova in the amount of leu 127 million, or 0.3% GDP.

1.3. Monetary and exchange policy

The National Bank of Moldova (NBM) has been pursuing a relatively rigid exchange rate policy since 2004, intervening heavily in the foreign exchange market. This is a result of the Moldovan **leu** (MDL) depreciating in real terms during 2001-02, and since the beginning of 2003, the MDL has come under fairly constant appreciation pressure. The MDL appreciation has been particularly strong against the US dollar, but it has appreciated against other currencies as well. NBM purchases of foreign exchange, which accelerated in the second part of 2004, have helped keep the MDL from appreciating against the US dollar. On the other hand, the large inflow of remittances has helped offset the depreciation pressures placed on the exchange rate by large trade deficits and accumulation of external payment arrears.

Further, the interventions by the NBM in the foreign exchange market have allowed foreign exchange reserves to increase rapidly, reaching a record level of USD 597.4 million at the end of 2005 (Table 6). Despite more intense sterilization efforts, however, the large inflows of foreign exchange have contributed to the rapid growth in both reserve and broad money. Since the beginning of the recovery, broad money growth has averaged 36% per annum, thus increasing inflationary pressure.

The economic recovery initially coincided with a period of disinflation, with inflation falling to less than 5% per year. Toward the end of 2003, however, inflation pressures re-emerged, partly as a result of unusually large increases in food prices (related to the poor harvest), and have been slow to decline to previous lows. The decline in inflation since 2000 has contributed to a steady decline in nominal interest rates. Throughout the recovery, however, real ex-post interest rates in Moldova have remained high, averaging roughly 13% in 2005 (Table 6).

Table 6. Internal and external debt, 2000-2005

Indicators	2000	2001	2002	2003	2004	2005
Annual inflation rate (medium), %	118.5	106.4	105.2	111.6	112.4	111.9
Interest rate on deposits in national currency, %	24.6	20.6	14.4	12.7	15.2	13.0
Exchange rate of Moldovan lei for 1 USD, end of year	12.4	13.1	13.82	13.22	12.46	12.83
Foreign currency reserves, mln. USD	270.0	250.0	268.9	302.3	470.3	597.4
Broad money/GDP, end of year, %	15.7	18.2	20.0	20.4	25.4	n.a.

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

Moldova's anti-inflation efforts have often conflicted with its objective of maintaining a pegged exchange rate. The pressure on the real exchange rate to appreciate has raised concerns that the exchange rate has become disconnected from the underlying competitiveness of the economy, rendering the traded goods sector less profitable, thus discouraging the production of exports and import substitutes.

While the interventions by the monetary authorities have helped to ease these pressures on the exchange rate, the resulting rapid growth in the money supply poses a risk for inflation. A number of studies, however, have suggested that prices and wages in Moldova, as well as in other CIS countries, are still below the level that reflects their true economic value. Thus, despite the real exchange rate appreciation experienced in 2003 and 2004, according to the estimates in these studies, the MDL is still undervalued by 20%-40%.

1.4. External sector

Current account deficits

Moldova's current account (CA) has persistently shown large deficits. The CA deficit in the crisis year of 1998 was as large as 20% of GDP. It was subsequently reduced but started to grow again in 2002 owing to a strong demand for imports. Exports and workers' remittances, however, have offset to some extent the negative effect of import growth on the balance of payments. Nevertheless, the country is very dependant on external factors. This highlights the particular importance of the balance of payments situation and the trends in relation to the 'rest of the world'.

The deficit of goods and services account of USD 1.2 billion reached 41.6 % of GDP in 2005. The trade deficit was offset to some extent by the surpluses of the income and current transfer accounts, due to the inflow of remittances. Therefore, the current account deficit was lower and amounted to approximately USD 0.2 billion or 8.3 % of GDP in 2005 (Table 7).

Table 7. Selected Balance of Payments statistics, 2000-2005

Indicators	2000	2001	2002	2003	2004	2005
Balance of goods and services, USD mil.	-330.5	-352.9	-418.1	-669.9	-776.1	-1214.7
Balance of goods and services/GDP, %	-25.7	-23.8	-25.2	-33.8	-29.9	-41.6
Current account balance/GDP, %	-7.6	-1.8	-1.2	-6.8	-2.0	-8.3
Foreign direct investments , net, USD mil.	127	102	132	71	148	120

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

Trade policy

Since 2001, Moldova has been a member of the World Trade Organization (WTO) and has been working hard on fulfilling its commitments regarding the liberalization of trade and trade policy reform. Moldova has undertaken clear commitments in relation to the conduct of economic policies, customs operations, the protection of intellectual property rights, standardization and technical barriers, and veterinary and phyto-sanitary measures. On a 10-point scale, the IMF has graded Moldova a “1”, classifying it as possessing the most liberal trade regime when compared to other countries in transition. The country’s liberal trade regime for both exports and imports[10] allows businesses to trade freely a wide range of goods, with the exception of products in categories such as weapons, precious metals, explosives, poisons, medicines, and medical equipment. Because the tariff policy of the Republic of Moldova is based on the trade regime established by the WTO, the country's consolidated classified list is quite liberalized. The weighted average tariff is 4.3%; the average customs tariff for agricultural products is 12.65%; and the average customs tariff for industrial products is 3.95%. Moldovan exports are not subject to customs duties, however, there is a fee amounting to 0.25% of the value of goods passing through customs that is charged for customs procedures.

The Republic of Moldova has been a beneficiary of the EU Generalized System of Preferences (GSP) since July 1, 1999. According to the GSP, Moldovan exports to the EU markets enjoyed partial or total exemption from customs tariffs. Since the beginning of 2006, the European Union offered a new scheme of preferences, known as GSP+, which covers a broader range of products than those included in the previous GSP and which can be exported to the EU tariff-free. As well, under the GSP, Moldovan exports enjoy tariff preferences in the markets of Switzerland, Japan and the US.

[10] Country Report #105/54, IMF, 2005, also available at www.imf.md

Further, Most Favoured Nation (MFN) agreements have been signed with 17 countries and when trading with other countries, except for the Commonwealth of Independent States (CIS), the principle of the country of destination is applied, such thatcustoms duties are imposed on imports at the border.

Moldova is a participant in a number of free trade areas: the multilateral CIS free trade area, consisting of the former Soviet republics (with Russia, Ukraine and Belarus as the most important trade partners of Moldova), until 2007 the bilateral Romania-Moldova free trade area, and, most recently, bilateral free trade arrangements with the other six Stability Pact countries of South Eastern Europe (SEE). The CIS free trade area still has an extremely important role in Moldova's external trade, absorbing over half of the country's exports, as compared to the less important trade with SEE countries, which only accounts for 11% of total trade, most of which is due to trade with Romania.

Trade flows

Following the initial shock of transition, external trade recovered with exports and imports growing strongly between 1995 and 1997, but they declined sharply as a result of Russia's financial crisis in 1998. Then, between 1999 and 2005, merchandise exports grew by about 13% per annum on average, while imports increased even faster, growing 20% per annum over the same period (Table 8).

Table 8. Trade in goods, 2001-2005

INDICATORS	2001	2002	2003	2004	2005
Exports growth, % (nominal, in USD)	118.4	116.8	122.0	123.5	111.1
Import growth, % (nominal, in USD)	114.2	117.9	137.6	122.4	131.3
Exports /GDP, %	38.1	39.7	40.6	38.3	37.9
Imports/GDP, %	- 59.4	- 62.4	- 72.1	- 67.3	-78.7
Trade balance/GDP	- 21.3	- 22.7	- 31.5	- 29.0	- 40.8
External trade turnover/GDP	97.5	102.1	112.7	105.5	116.6

Source: National Bank of Moldova.

With the growth of imports exceeding exports, Moldova has consistently been running large trade deficits, with the trade deficit in 2005 amounting to 41% of GDP (Table 8).

The second wave of trade growth, post 1998, has had one major difference from earlier periods. Trade is geographically broader, with trade with non-CIS countries growing more rapidly than trade with CIS countries.

Nonetheless, Moldova's exports remain highly dependent on the CIS markets, Russia in particular. Although the share of exports to these countries has been declining since 1997, at which time it reached its post-independence peak of 70%, the CIS still remains the destination for over 53% of Moldavan exports.

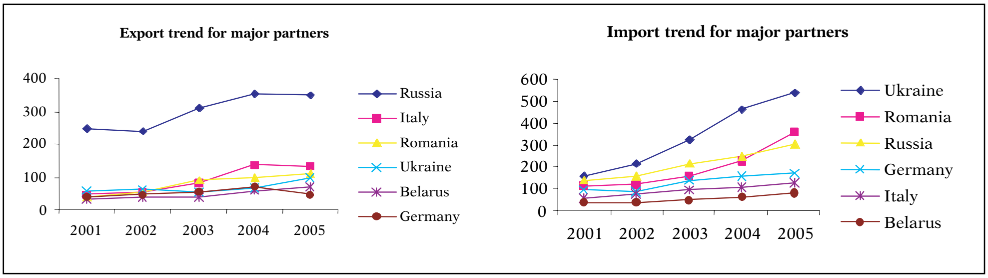
Table 9. Geographical structure of Moldovan trade, thousand USD, 2001-2005

	2001	2002	2003	2004	2005
Exports – total (USD)	565495	643792	789934	985174	091255
	%	%	%	%	%
CIS	60.9	54.4	53.6	51.0	50.53
EU	24.9	26.6	26.7	30.1	29.7
CEE	7.5	9.7	12.4	10.7	11.13
To other countries	6.7	9.3	7.3	8.2	8.64
Imports – total (USD)	892228	038000	1402347	1768534	292961
	%	%	%	%	%
from CIS	38.1	39.4	42.3	43.2	39.5
from EU	35.6	34.4	36.0	32.9	32.8
from CEE	13.2	11.1	9.5	11.3	12.75
from other	13.1	15.1	12.2	12.6	14.92

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

The increase in non-CIS exports has been mainly the result of increased exports to the European Union, with the share of exports to Romania and other SEE countries showing little overall change. The EU is currently the second largest export market for Moldova accounting for 28% of the market. The SEE countries account for 11% of Moldovan exports, with Romania being the largest of the SEE trade partners, with a 10% share, and Bulgaria a distant second at less than 1%. The increased non-CIS share of exports was driven largely by the significant drop in trade with Russia following the 1998 financial crisis. Since then, exports to the EU-25 have grown broadly in line with total exports, so that the share of EU exports in total exports has remained relatively constant at over 25%.

Figure 2. Main Moldovan trade partners, 2001-2005



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

Moldovan exports are heavily concentrated in a few product categories and this concentration has increased over time. The share of the top three export products[11] in total exports has increased from 39% to slightly over 53% between 1995 and 2005. Over the same period, the number of products that Moldova has exported has fallen, declining from 765 products in 1995 to 597 in 2004.

[11] Defined as the number of 4-digit HS export categories.

Moldovan exports are dominated by wine, fruits and vegetables, prepared food and apparel products. Wine is the single most important export item, comprising 28.8% of total exports in 2005, while nuts account for about 6% of total exports. The prepared food products make up 5% of exports, other fruits and vegetables contribute to an additional 12%, and apparel accounts for 15.6% of exports. Other significant products are skin and leather (6.6% of exports), cereals (3.9%),vegetable oils and fats (3.5%) and equipment (2.8%, Table 10).

The commodity composition of total trade disguises a significant difference between Moldova's trade with the CIS countries and its trade with SEE and the EU. Agri-food products account for more than 80% of exports to CIS countries, while exports to the EU are dominated by industrial products, which accounted for approximately 74% of exports from 2001-2005. Industrial products also dominate exports to SEE and other countries, accounting for 59% of exports respectively.

Moldovan imports have undergone a faster reorientation than exports, with the share of imports from non-CIS countries increasing rapidly since 1995. The share of imports from the EU grew very quickly in the early and mid-1990s and, by 2005, the EU was supplying over a third of Moldova's imports.

Table 10. Structure of exports/imports by group of commodities (%), 2005

		Exports	Imports
I	Live animals and animal products	1.6	2.5
II	Vegetable products	12.1	2.8
III	Animal or vegetable fats and oils	3.5	0.4
IV	Foodstuff products; alcoholic and non-alcoholic drinks; tobacco	36.3	6.4
V	Mineral products	1.8	22.0
VI	Chemical products	1.4	10.1
VII	Plastics, rubber and articles thereof	1.1	6.1
VIII	Raw hides and skins, leather, fur skins	6.6	3.0
IX	Wood and articles of wood (excluding furniture)	0.2	1.9
X	Pulp of wood, paper, paperboard and articles thereof	1.1	3.6
XI	Textiles and textile articles	17.8	7.8
XII	Footwear, headgear, umbrellas and similar articles	2.4	0.5
XIII	Articles of stone, gypsum, cement, ceramic, glass or similar materials	1.7	2.9
XIV	Natural or cultured pearls, precious or semi-precious stones, precious metals, metals clad with precious metals, and articles thereof; imitation jewellery; coin	0	0.3
XV	Base metals and articles of base metals	4.5	7.0
XVI	Machinery and mechanical appliances; electrical equipment; sound recorders and reproducers, television image and sound recorders and reproducers	4.2	13.7
XVII	Vehicles and associated transport equipment	1.4	5.7
XVIII	Optical, photographic apparatus, watches; musical instruments; parts and accessories thereof	0.7	1.2
XIX	Miscellaneous manufactured articles	1.6	1.9
	Total	100	100

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

Imports are also more geographically diversified than exports. There is a significant difference between Moldova's trade with CIS countries and its trade with the EU. Imports of machinery and equipment (25.4%), textiles (17.5%) and chemicals (12.6%) make up more than half of trade with the EU, while energy (44%) dominates imports from the CIS region. Also, most imported machinery and equipment are likely used for further manufacturing and the majority of imported textiles are intended for outward processing, demonstrating the growing share of textiles in exports and the low cost of Moldavan labour. However, there is a need to increase both the quantity and quality of investment, as well as a need to acquire skills in technology and design, production methods, plant management techniques and market expertise in order to add value to Moldovan exports of finished products.

Foreign direct investment

One of the first steps towards improving the investment climate was the approval of the new law on investment in entrepreneurial activity that entered into force in April 2004. This is the first document that applies principles of national treatment and provides equal rights to local and foreign investors. Core principles of the new law are freedom of investment location and type of business, transparency, and public consultations. The law also provides guaranteed remuneration to investors in case of expropriation or similar actions. In certain cases, subject to international agreements, the completion of business activity should be done with correct and advanced payment for losses.

According to the Law on Foreign Investment, the most important guarantees for foreign investors in Moldova include the following: protection from expropriation and nationalisation, the possibility to repatriate profits in hard currency and the right to take products acquired from the internal market outside of the country. Foreign and domestic private entities have the right to establish and own business enterprises and to carry out any business activity. The same standard is applied to both private and public enterprises with respect to access to market, credit, and other business operations, although in practice, the domestic financial market is not yet fully developed.

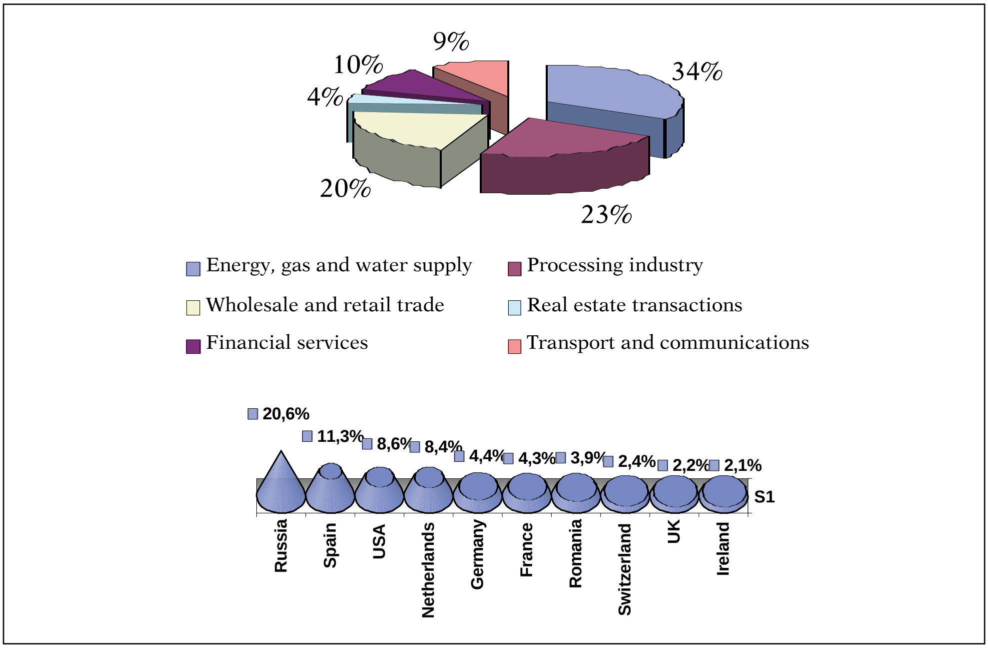
In 2005, Moldova's economy attracted FDI amounting to USD 225.3 million - a 16,4% increase compared to the previous year. At the beginning of 2006, there were

Table 11. Foreign direct investments, 2000-2005

indicators	2000	2001	2002	2003	2004	2005
FDI total, mln. USD	126.57	101.94	132.68	78.29	153.90	225.29
Equity capital	83.69	110.89	60.13	39.66	116.49	84.51
Reinvested earnings	-2.60	-36.64	22.68	21.18	37.83	72.04
Other capital	45.48	27.69	49.87	17.45	-0.42	68.74
Investments/GDP , %	n.a.	23.9	23.3	21.7	23.2	25.3

Source: National Bank of Moldova.

Figure 3. FDI by sectors and countries, 2005



Source: Moldovan Investment and Export Promotion Organisation.

4,342 enterprises with foreign capital registered in Moldova[12]. However, compared to other CIS countries, the level of FDI per capita in 2005 was one of the lowest in the region, at only 55 USD[13].

1.5. Social situation and human development

The labour market situation deteriorated noticeably in Moldova during the 1990s, in line with poor GDP performance. In the wake of the Russian crisis of August 1998, employment dropped by 18.2% per annum with employment growth only reappearing in 2003. A gradual improvement in unemployment has been recorded, falling from 11.1% at the end of 1999 to around 7.9% at the end of 2003. In 2005, the unemployment rate, calculated according to the International Bureau of Laour (IBL) methodology, registered a country level of 7.3% (table 12).

[12] Moldovan Investment and Export Promotion Organization

[13] According to the International financial statistics for 2005, the highest level of FDI per capita among CIS countries is in Azerbaijan (201 USD) and the lowest in Belarus (31 USD).

Table 12. Social indicators, 2000-2005

Indicators	2000	2001	2002	2003	2004	2005
Annual unemployment rate according to IBL, %	8.5	7.3	6.8	7.9	8.1	7.3
Average monthly gross salary, USD	33.9	33.3	50.9	63.9	89.5	104.7
Annual real growth rate, %	102.2	121.6	120.9	115.4	110.1	106.8

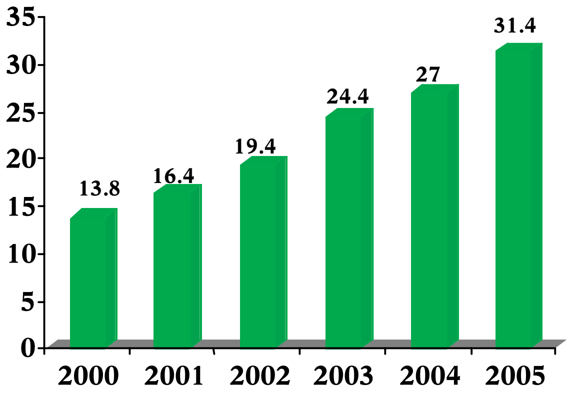
Source: National Bureau of Statistics of the Republic of Moldova.

Job creation is mainly confined to Chisinau and does not compensate for the job losses in the rest of the country. As a result, a large number of Moldavians seek employment abroad and are vulnerable to trafficking.

As stated in the first section of this chapter, there has been an increasing outflow of the Moldovan work force. The estimates for the number of Moldovans working abroad (mostly in Russia, South East Europe and the EU) vary widely. However, one thing is clear. Moldova's dependence on remittance flows are among the highest in the world[14]. The level of recorded migrants' remittances has increased enormously since the late 1990s. Balance of payment statistics indicate that they have grown nearly three-fold from 2000 to 2004, though there may be some discrepancies in how remittances were measured over this time period. Moldova's level of remittances, as a share of GDP, was the fourth largest in the world in 2003 at about 24% of GDP (USD 0.5 billion), rising to 31.4% in 2005.

However, this number only reflects the money that was sent to Moldova through the banking system. Large quantities of remittances, perhaps about 50%

Figure 4. Remittances as share of GDP, 2000-2005



Source: National Bank of Moldova.

[14] Following are the countries for which remittances represent the highest share in GDP in 2004: Tonga - 31%t, Moldova - 27.1%, Lesotho - 25.8 %, Haiti - 24.8%, and Bosnia-Herzegovina - 22.5%.

more, are sent through informal channels and are not well recorded in balance of payments estimates, therefore, the actual total number of remittances in 2005 is likely to be higher than 31% of GDP.

1.6. Financial intermediation

The banking system in Moldova is healthy, with high levels of earnings, capitalization and liquidity as well as a low level of non-performing assets. Approximately 60% of the banking system's assets are composed of loans and they ensure 60% of most banks' income[15]. Due to insufficient capital of enterprises and the low level of domestic and foreign investments, the role of the banking system as the main creditor of the economy has grown significantly. While the financial sector has been growing quickly, it still remains small relative to GDP and many firms are finding it difficult to gain access to credit. In 2005, total deposits were still only 25% of GDP - a 12% increase since 2000[16]. On the asset side, total assets of the banking system were equivalent to 49% of GDP at the end of 2005. The growth in assets has been driven by very rapid increases in domestic credit, averaging over 30% a year since 2000.

The insurance sector in Moldova is small and underdeveloped. In 2004, the Moldovan insurance market's gross premium income was approximately USD 20.9 million[17]. This puts it among the smallest in Europe and at the bottom of the league table of East European economies in transition. Market penetration in 2004 was about 1%. There are currently 50 licensed insurance companies, a number that is considered more than the current market can support, most of which are extremely small by international standards. Further, there is virtually no life insurance market[18].

The economic growth of recent years has been reflected in the insurance market with gross direct premiums increasing, in monetary terms, by 50% between 2004 and 2005. There is a commitment at the senior levels of government to encourage the development of a healthy and competitive insurance market that will serve the needs of consumers and contribute to national economic growth. The new law on insurance envisages the establishment of an independent insurance regulator and supervisor, an increase in the capital requirements, and the harmonization of prudential requirements with applicable best practice standards.

[15] EGPRSP evaluation report, 2005.

[16] National Bank of Moldova.

[17] IMF country report No 65/04, February 2005.

[18] The importance of life insurance is negligible, implying that the industry cannot be considered as a major source of long-term capital for the country. Several factors have contributed to these very low levels of insurance penetration, including low-incomes.

1.7. State involvement in the economy and privatization

Despite a good start in the early 1990s and positive subsequent results in some areas (e.g. accession to the WTO in 2001), Moldova's achievements in structural reforms and the creation of a fully functional market economy remain partial. Since 2000, reform has slowed noticeably due to increasing political demands for state interventions. New regulations do not always present coherent and consistent underlying strategies. Moreover, regulations are often ignored or circumvented with widespread corruption further complicating the situation.

State involvement in the economy is still extensive, especially in some sectors, yet the private sector still accounts for 75% of GDP. Specifically, privately-owned enterprises account for 60% of industrial production, 70% of the services rendered in retail trade and public services, and 44% of the volume of works in construction and transport.

Little progress in selling state-owned assets has been visible since 2000 (see), highlighting the difficulties encountered by both large and small-scale privatisation. Several important asset sales, such as the sale of the state telecom company Moldtelecom, failed or were postponed. A crucial element in the failure of the privatisation programme to reach planned targets was the lack of interest by international investors. Heavy administrative procedures are an additional aspect of excessive state involvement in the economy. At present, 50.2% of all enterprises have been privatised in the industrutrial sector, including 93% of agricultural raw material processing enterprises and 82% of light industry enterprises[19]. Also, the share of privately operating farms has been growing strongly. It should be noted that the country depends to a large extent on foreign capital to complete the privatisation process and to finance enterprise restructuring.

Table 13. Private ownership and privatisation revenues, 2000-2005

Indicators	2000	2001	2002	2003	2004	2005
Private sector share in GDP, %	50.0	50.0	55.0	55.0	60.0	75.0
Privatisation revenues in % of GDP	2.9	0.4	0.6	0.2	0.1	0.1*

Note: * - estimate
Source: MIEPO - private sector share of GDP, IMF country report No. 06/184, 05/48 - privatisation revenues.

Moldova rates poorly in terms of corporate governance and enterprise restructuring. According to an EBRD indicator, Moldova's rating in this category is among the 4 lowest of the 27 transition countries. Thus, the government has acknowledged the importance of private capital in the revival of the national economy. In particular, high importance has been placed on directing capital investments in infrastructure development, including public-private partnership.

[19] MIEPO.

1.8. Regulatory framework and private sector development

The business environment in Moldova has improved since 2005 in terms of access to finance, taxation, incidence of crime and, to a lesser extent, corruption[20]. However, entrepreneurs still report major barriers relating to regulation, tax administration and state interference, as well as an inefficient judiciary and ineffective customs system.

The license system and procedures were simplified in 2002 through establishment of the Chamber of Licensing - the official authority for issuing licenses. Also, the number of activities requiring a license was reduced from 106 to 49 between 2001-2005.

Moldova has had basic competition legislation in place since 1992. The current legal framework is set out in the Law on the Protection of Competition of 2000, which prohibits abuse of dominance, anti-competitive agreements, and actions of public administration authorities who limit competition. This law provides for the creation of an independent National Agency for the Protection of Competition. However, the new Agency remains to be set up. One of the main reasons for this is a lack of political will and and a lack of efficient regulation of anti-monopoly and competition protection activities. Until recently, there was no coherent and strict policy in this domain, while anti-monopoly functions have been delegated to several state structures, including the Ministry of Economy and Trade.

1.9. Metrology, standardization, testing, quality and market surveillance

The development of standards is a tremendous task requiring a vast supply of resources, expertise and time. As the primary trading partners of Moldova have been CIS countries, Moldova has not realized the importance of harmonizing its standards with those of highly developed economies. However, changes began with the accession process of Moldova into the WTO in 2001. Not only did the legislation begin to change but various governmental strategies and programs began to consider the move to voluntary standardization. Also, since there are essentially no technical regulations in Moldova, and such regulations are mandatory, a technical regulations program was adopted in 2005.

The conformity assessment system in Moldova has been improved recently, but unfortunately the Moldovan quality assessment system is not yet recognized by the European countries. To date, Moldova has recognition agreements only with CIS countries and Romania for mutual acceptance of conformity certificates and laboratory testing results.

[20] 2005 EBRD/World Bank Business Environment and Enterprise Performance Survey.

Finally, market surveillance is a separate and important subject. Moldova, in general, does not have such activities and instead uses state control and supervision in this capacity. This is carried out by numerous state organizations, including the Standardisation and Metrology Service, and is a considerable burden to business development. Inspectors have many rights to access and harass businesses at all stages of activity such as, product development, delivery, transportation, storage, sales, and utilization of products. No clear differentiation is made in legislation between products from regulated and unregulated areas.

1.10 Summary

As a small open economy with a significant share of economic activity generated in its agricultural and related agro-processing sector, Moldova remains vulnerable to external shocks. Currently these include variable weather conditions, significant increases in energy prices and the prohibition of exports of certain commodities to Russia.

With regard to the sources and sustainability of GDP growth, the challenge is to gradually move from the existing, situation characterized by the predominance of demand-side induced growth as a result of remittances and their effect on domestic consumption, to a situation characterized by a sustained domestic supply-side response. The latter should be based on successfully attracting both domestic and foreign investment.

A key observation, concerning the importance we assign to the economy's supply-side response and prospects for the country's future growth and development, is that with the sustained recovery of GDP over the period of 2000-2005, we have moved away from a situation which was previously characterized by significant under-employment of the economy's factors of production (i.e. capital and labour).

With regard to the stock of capital, it is notable that to date, increased production has been based on higher capacity utilization of existing plants and equipment rather than new additions to the economy's capital stockor investment. In particular, although investment has been growing, it has remained relatively low, while depreciation has eroded the economy's capital stock further over this period.

With regard to labour, there has been a shift in the supply of labour in the domestic labour market due to the significant migration flows. Currently there are indications of labour shortages in a number of sectors, while at the macroeconomic level, the evolving situation has been characterized by increases in the average wage that were higher than the inflation rate and productivity changes.

Chapter 2.
EU-Moldova relations

2.1. Partnership and Cooperation Agreement

The current legal basis of EU - Moldova cooperation is defined by the Partnership and Cooperation Agreement (PCA). The PCA was signed onNovember 28, 1994 and came into force in July of 1998 for an initial period of ten years. It established the institutional framework for bilateral relations, set the principal common objectives, and called for activities and dialogue in a number of policy areas. Moldova welcomed the EU enlargement and signed the protocol extending the PCA to the new EU member states on April 30, 2004.

The signing of the PCA established bilateral relations between the European Union and Moldova. By signing the PCA, Moldovan authorities succeeded in giving more weight to the status of the country as an international player, as well as credibility to its democratic image. At the same time, the European Union committed itself to support Moldova's efforts to consolidate democracy and finalise the transition to a market economy[21].

However, the results of the PCA fell short of initial expectations. Four years after the PCA came into force, the priorities were re-established. In fact, there was reduced cooperation in many areas, most likely due to both the passive attitude of the Moldovan authorities and the lack of a clear EU strategy towards Moldova.

The PCA covers all policy areas from foreign and security policy, trade and economic cooperation, 'softer' security threats like drugs, crime, and human trafficking, and environmental policy. The Agreement provides legally binding yet only partialy defined objectives in these fields. (Box 1)

The PCA also sets up the institutional structures within which cooperation should take place. According to Article 87 of the PCA, the Parliamentary Co-operation Committee between the European Parliament and the Moldovan Parliament was

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[21] An Assessment of the Present Status of the Republic of Moldova's Accession to the European Union, (Studies Synthesis), Dr. Oleg Serebrian.

Box. 1. Partnership and Cooperation Agreement between the EU and Moldova

The PCA covers:

- Trade and economic co-operation: liberalisation of trade based on Most Favoured Nation treatment and the elimination of quantitative restrictions; legislative harmonisation (provisions governing goods, services, labour, and capital, as well as competition and intellectual property protection, aiming at bringing Moldova in line with the legal framework of the single European market).
- Co-operation in the fields of science and technology, energy, environment, transport, postal services and telecommunications and a range of other areas such as education and training, social and cultural cooperation.
- Political dialogue on domestic, regional and international issues of mutual concern such as observance of principles of democracy and human rights and political stability in the region (particularly related to the Transnistria region).
- In Justice and Home Affairs, the PCA sets out specific areas for co-operation such as money laundering, measures to counter illicit production, and the fight against drugs.

Source: http://ec.europa.eu/comm/external_relations/moldova/intro/index.htm

created in 1998 after the ratification of the PCA. These structures have been used regularly since 1998, and work under the PCA further intensified in 2003.

The Co-operation Council at the Ministerial/Commissioner level (EU-Presidency, European Commission, High Commissioner, government of Moldova) has the overall responsibility for running the PCA and last met on February 22, 2005. The Co-operation Committee meets at the senior civil servants level (chaired either by the European Commission or by the Moldovan side) with its last meeting taking place on October 19, 2006 in Brussels. It is supported by sub-committees specialising in specific sectors that deal with more technical issues such as trade and investment, financial, economic and statistical issues, customs and cross-boarder cooperation, justice and home affairs, energy, environment, networks, science and technology, training, and education. The Parliamentary Co-operation Committee between the European Parliament and the Moldovan Parliament holds two meetings a year – one in Brussels and one in Chisinau. The last meeting took place in Strasbourg on October 25-26, 2006.

2.2. Moldova as a partner in European Neighbourhood Policy

European Neighbourhood Policy

From 2004-2005 the European Union's strategy towards Moldova has been integrated into the new European Neighbourhood Policy (ENP). This new approach towards their neighbours was the natural consequence of the 2004 enlargement when the EU borders moved further to the east. For a country such as Moldova, the policy has a forward-looking component, anticipating the planned accession of Romania and the emergence of the new EU border with Moldova in 2007.

The European Commission has approached the issue of its new neighbours through a focused policy aimed at "developing a zone of prosperity and a friendly neighbourhood with whom the EU enjoys close, peaceful and co-operative relations"[22].

The EU offers its neighbours a privileged relationship, building upon a mutual commitment to common values such as democracy and human rights, the rule of law, good governance, principles of a market economy and sustainable development. The ENP goes beyond existing relationships to offer a deeper political relationship and economic integration. The depth of this integration will depend on the extent to which these values are effectively shared. The ENP is not about enlargement and does not offer an accession perspective.

The ENP works on the basis of mutually agreed upon Action Plans. These plans identify priorities for action across a broad range of areas. An Action Plan agreed with each of the ENP partners is focused on its particular needs and capacities, in line with the principles of joint ownership.

The European Commission stated that "the aim of the Neighbourhood Policy is to provide a framework for the development of a new relationship which would not, in the medium term, include a perspective of membership or a role in the Union's institutions"[23]. The new vision is for an open and integrated market functioning on the basis of compatible or harmonized rules and further liberalization. In terms of specific actions, the Commission proposed that all neighbouring countries should be offered the prospect of a stake in the EU's Internal Market and further integration and liberalization to promote the "four freedoms" of the free movement of persons, goods, services and capital.

The idea of building a safe and wealthy neighbourhood has received warm support from EU citizens. A recent survey found that Europeans believe that encouraging and supporting reforms in neighbouring countries will bring benefits for the EU's neighbours in terms of economic and social development, as well as, good governance. (Box 2) They also expect that promoting stability and a favourable economic environment, in addition to the mutual opening of markets, will contribute to prosperity within the EU. They see overall benefits to cooperation with neighbours, particularly working together to tackle shared challenges, such as security to reduce and prevent terrorism and organized crime, environmental protection, energy and migration[24].

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[22] Wider Europe "Neighbourhood with the Eastern and Southern Neighbours, New Framework for Relations", 2003.
[23] European Commission Communication on the Wider Europe COM (2003) 104 final p.3.
[24] http://ec.europa.eu/public_opinion/archives/eb_special_en.htm

Box. 2. EU citizens support the idea of the ENP

A recent survey on the European Neighbourhood Policy reported that:

- EU citizens tend to have a positive perception of relations with neighbouring countries (68% of respondents) and to believe that cooperation with these countries will bring mutual benefits. EU citizens consider cooperation with neighbouring countries important in: fighting organised crime (90%) and terrorism (90%), economic development (88%), energy matters (87%), environment (87%), democracy (87%), education and training (83%), research and innovation (78%) and immigration (77%).
- On the highly topical issue of migration, nearly two thirds of respondents (64%) believe that close cooperation with neighbouring countries will reduce illegal immigration in the EU.
- The vast majority consider that EU assistance to neighbouring countries can help to extend peace (70%) and democracy (77%) beyond the borders of the Union. There are, however, concerns (45%) that their own country's peace and stability could be endangered by promoting reforms in neighbouring countries.
- A majority of those questioned felt that economic cooperation with the neighbours would increase mutual prosperity (61%) and open new markets for both parties (75% for the EU and 64% for neighbouring countries). This is in spite of the fact that many (81%) had concerns about the potential financial costs of supporting reforms in Europe's neighbourhood.
- Most respondents, (52%) feel that countries are willing to cooperate in reform, though a majority (64%) also feels that the EU should reduce its relations with a country if it shows no willingness to make progress on reforms.

Source: http://ec.europa.eu/public_opinion/archives/eb_special_en.htm

Moldova in the ENP

The current EU approach to its relations with the Republic of Moldova has developed in the context of the ENP. The policy is based on the following principles, applicable to Moldova:

- The policy is targeted at states that do not currently have the perspective of membership. The logic is not of enlargement but of interdependence;
- The ENP is founded on the concept of 'differentiation and progressivity'. The project proposes a bargain. In return for progress in demonstrating the shared values and effective reform, neighbours may benefit from the prospect of closer economic integration. The ENP offers the prospect of a stake in the internal market;
- Actions Plans constitute the basic method of cooperation;
- The political and security role of the EU receives strong emphasis;
- The policy contains notions for the future. The possibility of moving beyond the PCA is raised for those states that fulfil the Action Plans[25].

[25] Lynch, Dov The European Neighbourhood Policy, 2004.

The main instrument to implement the European Neighbourhood Policy is the Action Plan developed jointly by the EU and Moldova in the first part of 2004 and jointly adopted at the Cooperation Council on February 22, 2005 (EC, 2006a).

Finally, it must be mentioned that Moldova has been constantly declaring its decision to join the European Union in the future, but the Neighbourhood Policy has yet to give a clear perspective for Moldova on the issue.

Priorities identified in the Action Plan

The priorities identified in the Action Plan cover the strengthening of administrative and judicial capacity, ensuring respect for freedom of expression and freedom of the media, and cooperation on economic and regulatory issues with the aim of improving the business climate and enhancing the long-term sustainability of economic policy. A number of cross-cutting issues related to border management, management of migration and the fight against trafficking, organised crime and money laundering are also identified as priorities for the EU-Moldova enhanced cooperation.

Box. 3. Key Priorities of the European Union- Republic of Moldova Action Plan

- **Political dialogue:** reform of electoral legislation, taking into account all of the ODIHR and Council of Europe recommendations, strengthen independence of the judiciary and fundamental freedoms, including in particular parliamentary immunity, freedom of expression and pluralistic media and fight against corruption, active engagement in negotiations for settlement of the Transnistria conflict and cooperation with the border mission;
- **Economic reform and trade**: ensure macroeconomic stability, in particular by fighting inflation and pursuing fiscal discipline and transparency in public finance, early agreement with IMF on a new lending programme, reform the system of certification of origin, improve the business climate, transparency and predictability, reduce over-regulation, reform the system of certification of origin;
- **Justice, freedom and security**: amend legislation related to the fight against crime and trafficking in persons, adopt and begin implementing the National Action Plan on migration, hold a second meeting of the expert working group on legal migration, improve legislation on asylum and migration and ensure effective implementation of the legislation, participate in regional and cross-border cooperation on migration;
- **Customs**: improve institutional framework and procedures on control of origin in order to build a solid basis for possible Autonomous Trade Preferences;
- **Sectoral issues**: establish measures for gradual convergence towards the principles of the EU internal electricity and gas markets and cooperation for regional energy market integration, adopt and implement a Road Safety Action Plan (including dangerous goods transport and roadworthiness), cooperation in protection of the Danube and Black Sea, strengthen the capacities of the regulator for electronic communications, work towards the implementation of educational reform in line with the Bologna Process.

Source: Communication of the Commission Implementing and Promoting the European Neighbourhood Policy, Brussels, 22 November 2005, SEC (2005) 1521

Moldova and the EU cooperate closely in implementing the Action Plan the new Moldovan government, in office since April 2005, has put it at the centre of Moldova's reform programme.

"Successful implementation of the Action Plan will help Moldova to pursue the objectives set in the PCA and will help Moldova to further integrate into European economic and social structures. Implementation of the Action Plan will significantly advance the approximation of Moldovan legislation, norms and standards to those of the European Union. In this context, the Action Plan will build solid foundations for further economic integration based on the adoption and implementation of economic and trade-related rules and regulations with the potential to enhance trade, investment and growth. It will furthermore help to devise and implement policies and measures to promote economic growth and social cohesion, to reduce poverty and to protect the environment, thereby contributing to the long-term objective of sustainable development"[26].

It is clear that the ENP and the Action Plan have brought a new dynamic to relations between the EU and Moldova. These advantages are the following:

- Extended cooperation opportunities;
- Specified and detailed cooperation process between the parties:
- Updated areas of dialogue;
- More operational, visible and participative dialogue regarding EU enlargement with respect to Moldova;
- More elements of conditionality, especially with regard to political dialogue and reform, thus emphasising the necessity of democratic transformations as a prerequisite for further developments in other cooperation areas;
- Bringing Moldova into a different spatial perspective based on the European neighbourhood and proximity concepts.

For the efficient implementation of the EU-Moldova Action Plan, the Moldovan government elaborated the National Plan for the Implementation of the EU-Republic of Moldova Action Plan, which establishes all necessary measures to be taken, responsible institutions and terms for their realisation. With the same purpose, on August 1, 2005, the government of Moldova set up four inter-ministerial commissions for the promotion of European integration policy, as well as for the implementation of the EU-Moldova Action Plan. These commissions are the following:

- Commission for law and security issues (responsible ministry - Ministry of Justice);
- Commission for social and economic issues (responsible ministry - Ministry of Economy and Trade);

[26] EU Country Strategy Paper 2004-2006, National Indicative Programme 2005-2006 Moldova, page 5.

- Commission for infrastructure issues (responsible ministry - Ministry of Transport and Road Development);
- Commission for cultural - humanitarian issues (responsible ministry-Ministry of Education, Youth and Sport).

The line ministries and responsible bodies are presenting monthly, quarterly and annual reports to the coordinating ministries, while the Ministry of Foreign Affairs and European Integration provides general monitoring at the governmental level and informs the European Commission about the achieved results in the implementation of the Action Plan.

It should be noted that Moldovan civil society is actively involved in the monitoring process of the implementation of the EU-Moldova Action Plan and Moldovan NGOs have implemented several projects related to this issue[27]. Many outstanding analysts from Moldova are stressing the fact that the reports made by Moldovan NGOs seem to be more accessible to the public and more objective. Apart from acknowledging the progress achieved, attention has also been paid to the drawbacks in the implementation process. According to the NGOs, as of September 2006, Moldova has made moderate progress in implementing the Action Plan, with the majority of problems yet to be resolved in the judiciary system and in observance of the human rights.

According to the Action Plan, the European Commission will also undertake the first review of the implementation of this document within two years of its adoption. Moreover, by the end of 2006, the European Commission will produce the first monitoring report on the implementation by the Republic of Moldova of the Action Plan. The report of the last visit of the European Parliament delegation to Moldova, which took place from June 27-30, 2006, also stated with satisfaction, that the establishment of the EU Border Assistance Mission (EUBAM) since December 2005 has been very effective and successful, placing the country in a favourable situation for the resolution of the Transnistrian conflict. Also, members have realised that since the last visit of the European Parliament Delegation in October 2005, Moldova has made significant progress in adopting important legislation, such as the audiovisual code, and in harmonising them with the *acquis communautaire* and international standards. However, the delegation also stated a significant deficit in some areas of the implementation of the legislation and

[27] For example, the ADEPT Association and the EXPERT-GRUP Centre jointly implement the project 'The European Union - Republic of Moldova Action Plan: A document accessible for the public', which aims to create a wide and open framework for knowledge, promotion and debating the implementation of the Action Plan. The Soros Foundation-Moldova works on the European Initiatives Program which aim to support the process of European integration of Moldova, both regarding the implementation of the European Union - Moldova Action Plan (EUMAP) and other documents that parties might conclude in the context of a closer relationship.

stated insufficient progress, especially in fighting high-level corruption, respect for human rights, freedom of media, and fair and transparent implementation of legislation in justice procedures[28].

2.3. EU-Moldova bilateral trade relations

Trade policy

The EU granted trade preferences to Moldova for its textile exports as early as in 1995. In 1999, those preferences were extended to a basic GSP treatment similar to the one that other transitional and developing countries were benefiting from. It included a list of 7,000 products from the General Nomenclature that received, depending o classification into either sensitive or non-sensitive categories, partial or full exception from customs tariffs under the Most Favoured Nation treatment. Since 2000, after complying with a list of commitments[29]. Moldova qualified for additional trade preferences over the basic GSP rates under the 'social clause'. Nevertheless, the use of the GSP is of limited advantage for Moldova as most of its production falls into the sensitive category.

Moldova's preferential exports to the EU under the GSP have steadily increased, from EUR 77 million in 2000 to EUR110 million in 2002. Moldova is now ranked 33rd out of the 178 beneficiaries of the EU's GSP. GSP preferences are particularly important for exports from Moldova in the clothing and footwear sectors, which together represent more than two-thirds of preferential imports.

For the period 2006-2015, the EU is granting a new preferential scheme to Moldova, called GSP+. According to the Commission Decision's made on December 21, 2005, Moldova is a beneficiary country of the GSP+, which means that the country has duty free access to the EU market for 7,200 group of products out of a total of 11,000, which is 3,000 more groups than prior to 2006. Nevertheless, in order to benefit from the GSP+, the EU required that Moldova fulfil three conditions:

- **the goods must originate in a beneficiary country** in accordance with the EC GSP Rules of Origin;
- **the goods must be transported directly** from the beneficiary country to the EC;

[28] Press Release, Bureau Visit to Moldova, 27-30 June 2006, http://www.europarl.europa.eu/intcoop/euro/pcc/d_md/statements/2006_06_29.pdf

[29] That basically covered acceding to a list of international convention on labor code (eight ILO Conventions concerning the four areas to which the 1998 ILO Declaration on Fundamental Rights and Principles at Work refer: #29 and #105 on the elimination of all forms of forced or compulsory labor; #87 and #98 on the freedom of association and the effective recognition of the right to collective bargaining, #100 and #111 on the elimination of discrimination in respect of employment and occupation, and #138 and #182 on the effective abolition of child labor. Currently only Moldova and Sri-Lanka (that fulfilled the environmental clause) benefit from additional benefits to the basic GSP.

- **a valid proof of origin** must be submitted (certificate of origin Form A, issued by the competent authorities in the beneficiary country, or invoice declaration)[30].

The new system is more stable, predictable and simpler to administer. The rules of origin requirements have also been simplified. Furthermore, the GSP+ includes a graduation scheme for those products that reach a threshold larger than 15% of total imports to EU in their product category (the threshold for textiles is 12.5%). This implies suspension of preferences for those exports that became strong enough to be able to face market competition. Finally, the EU also reserves the right to suspend the system in case of systemic failings in beneficiary countries.

Furthermore, in 2004, the European Commission established a double-checking system, without quantitative limits, with respect to certain steel products originating from Moldova in order to improve transparency and avoid possible trade diversions. This measure was introduced to prevent the smuggling of steel products through Transnistria. In this way, Moldova is protecting its country image, whereas the EU makes sure it only gives preferential treatment to eligible products.

EU-Moldova trade flows

The EU is Moldova's second most important trading partner after the CIS with a share of 29.7% of the total bilateral exports. Bilateral trade with the EU totalled EUR 1.1 billion in 2005. In the same year, 27% of Moldovan exports went to the EU and 33% of imports were from the EU. Moldova primarily exports agricultural and food products, textiles, and base metals and articles. Its main imports from the EU are machinery, electrical products, agricultural products and textiles.

Table 14. EU-Moldova Trade in Euro millions, 2001-2006

Year	Imports	Yearly % change	Share of total EU imports	Exports	Yearly % change	Share of total EU exports	Balance	Imports + exports
2001	258		0.03	508		0.06	250	766
2002	288	11.5	0.03	521	2.4	0.06	233	809
2003	351	21.8	0.04	645	23.8	0.07	294	995
2004	451	28.7	0.04	735	13.9	0.08	283	1186
2005	361	-19.9	0.03	798	8.7	0.08	437	1160
1Q2005	79		0.03	145		0.06	66	224
1Q2006	89	12.2	0.03	169	16.5	0.06	81	258
Average annual growth		8.8			11.9			10.9

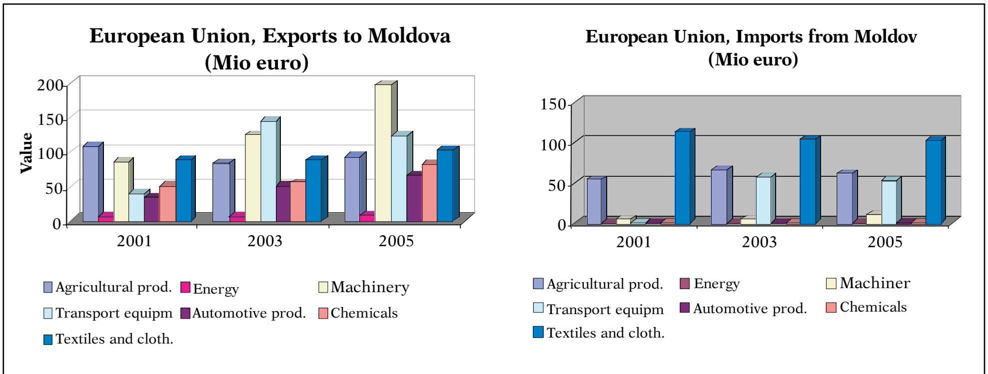
Source: Eurostat (Comext, Statistical regime 4)(excerpted from http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111540.xls)

[30] The European Community's Rules of Origin for the Generalised System of Preferences, a Guide for Traders, July 2002, European Commission.

Despite the reduction in tariffs, export growth to the EU markets remains quite modest (Table 14) The trade deficit reached EUR437 million in 2005 and is expected to grow in the coming years. This was due to the fact that Moldova imports mainly non-sensitive manufacturing products from the EU, while it primarily exports sensitive products. This can be illustrated by the structure of Moldovan import tariffs. The average weighted Moldovan customs tariff for EU products is regarded as very low at just 4.3%. In 2003, it was below that applied by the EU, including the GSP with 'social clause', of 5.6%[31]. For 2004, the average weighted Moldovan tariffs on EU imports decreased to 3.7%, whereas the simple average was 6%.

Of the EU Member States, Moldova's greatest trade partners are Italy and Germany with export shares in 2005 of 14% and 7%, respectively. The high concentration of exports in these two member states is partially explained by the popularity of outward processing for textiles. The proximity to the EU markets and the cheap, skilled labour force has made Moldova an outsourcing target of the largest manufacturing producers in Western Europe.

Figure 5. Geographical structure of EU-Moldova trade, millions of Euro, 2001-2005



Source: Eurostat (Comext, Statistical regime 4) (excerpted from http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111540.xls)

Table 15. Rank of Moldova in European Union trade, 2005

SITC rev. 3 Products Group	Imports from Moldova: rank	mil. euro	share of total EU imports	%	Export to Moldova: rank	mil. euro	share of total EU exports	%	Balance
TOTAL	100	361	0.03	100	83	798	0.08	100	437
Agricultural products	102	61	0.08	17.0	74	93	0.15	11.7	32
Energy	96	0	0.00	0.0	82	9	0.02	1.2	9
Non-agricultural raw materials	85	0	0.00	0.0	68	5	0.03	0.6	5
Office/telecom. Equipment	87	2	0.00	0.5	69	85	0.09	10.7	84
Power/non-electrical mach.	71	7	0.01	1.9	87	91	0.06	11.4	84
Transport equipment	56	53	0.05	14.6	75	124	0.07	15.5	71
Chemicals	97	1	0.00	0.4	82	82	0.05	10.3	81
Textiles and clothing	45	102	0.14	28.2	39	103	0.31	12.9	1
Iron and steel	36	28	0.18	7.7	116	2	0.01	0.2	-26

Source: Eurostat (Comext, Statistical regime 4), (excerpted from http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111540.xls)

2.4. Regional trade integration on the way towards Moldova-EU integration

Irrespective of progressing with commitments set out in the EU-Moldova Action Plan, Moldova started to integrate with the Western Balkans, Bulgaria and Romania. This process aims at an advanced stage of trade integration, along with harmonising norms and procedures with that of the EU. The final goal is to create a Balkan free trade area known as the new Central European Free Trade Agreement (CEFTA), where a significant number of goods can be traded at zero tariff rates and with low non-tariff barriers across national borders.

At the moment, a network of free-trade agreements (FTAs) has been created in the Balkans. Moldova signed FTAs with Romania, Bulgaria, Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro. The FTA with Romania dates back to 1994. Other FTAs began being implemented (with transitional periods) in 2004-2005. With the exception of the FTA with Romania, the coverage of agreements is mainly manufactured goods. The new CEFTA (formed by the Western Balkans and Moldova) was signed on 19 December 2006.

The rules and procedures accompanying the lowering of tariffs under CEFTA (or regional FTAs) are particularly important for future integration with the EU. They refer to the WTO or the EC rules (in particular to the EU system of rules of origin), and in this view, regional trade integration has laid the groundwork for further trade integration with the EU, in particular, for the smooth implementation of the future EU-Moldova FTA in manufacturing.

2.5. Economic aspect of the Transnistrian conflict

Special attention in the EU- Moldova Action Plan is allocated to the Transnistrian conflict[32]. The EU supports sustained efforts towards a settlement of the Transnistria

[31] "The Republic of Moldova Diagnostic Study", World Bank, December 23, 2004.

[32] In the wake of moves to rejoin Romania and following Moldova's independence, a separatist movement in the Transnistrian region on the left bank of the Nistru River declared on September 2,1990 a 'Transnistrian Moldovan Republic'. Tension rose and in 1992, armed clashes occurred between Moldovan government forces and Transnistrian separatists, resulting in several hundred deaths and the flight of tens of thousands of refugees. Negotiations with the Transnistrians have proved difficult. Eventually in 1997, Moldova and Transnistria signed a Memorandum on the bases for Normalisation of Relations with international backing. This memorandum established the framework for negotiations to reach a political settlement, involving the Moldovan and Transnistrian authorities with Ukraine, Russia and the OSCE as mediators. This agreement foresaw a broad degree of autonomy for Transnistria within a unitary Moldovan state; foreign and security policy would remain the preserve of central (i.e. Moldovan) government. However, no agreement was reached and the negotiations remained sluggish. Progress since then has been limited, although the Ukrainian settlement proposal put forward in March 2005 has given some impetus to the process.

conflict, respecting the sovereignty and territorial integrity of the Republic of Moldova within its internationally recognised borders, and guaranteeing respect for democracy, the rule of law and human rights. This conflict is of great concern for Europe, especially given Moldova's position as a future neighbouring country of the enlarged EU. Not only is Moldovan territorial integrity undermined, but there are serious security concerns as well, including alleged arms smuggling to other regional conflicts, and cigarette, human and drug trafficking to the West.

The EU and its Member States actively support the process of settlement of the conflict with the separatist region, in full coordination with the OSCE (Organization for Security and Co-operation in Europe). A key aspect of the settlement process regards ensuring Moldova’s control over its entire customs territory, including Transnistria. In this way, Moldovan authorities can operate efficiently, reduce crime, benefit from higher budget revenues and no longer be concerned about the integrity of the country. In this regard, it is hoped that so far ‘unsolvable’ problems will gradually disappear as a result of new policies.

Box. 4. Transnistrian economy

Transnistria relies heavily on external trade. Much of its trade consists of the output from large enterprises left over from Soviet Union times. The largest, the Moldovan Metallurgical Plant, accounts for roughly 60% of legal exports and approximately half of tax revenues. Other major firms include Sheriff, an increasingly dominant chain of supermarkets and petrol stations that has built a state-of-the-art football stadium in Tiraspol, Tirotex (textiles), Electromash (machine -building) and Kvint (cognac and wine), which wass recently purchased by Sheriff. These companies send the bulk of their products to the CIS, primarily Russia, Ukraine and Moldova, but they also export to the world market, including Western Europe and the US. According to one study, a third of Transnistrian exports in 2004 went to the EU, primarily to Italy and Germany.

According to the Moldovan Customs Service, the registered value of goods traded across Transnistrian border during from March 1- October 4, 2006 constituted MDL 3.2 billion, including exports - MDL 2.77 billion and imports -MDL- 427.4 million. The goods intended for export are mainly metal, clothes, footwear, electric motors/engines, alcoholic beverages, canned goods and others. Imported goods are primarily used in processing and include fabrics, cow and pig leather, plastic products, components for finishing manufactured production and labels. Russian subsidies, direct or indirect, play a crucial role in the Transnistrian economy. Transnistria is given a preferential rate for its natural gas imports and is rarely asked to pay even that. It has run up a billion dollar debt to the Russian gas company Gazprom, which neither side seems particularly intent on settling. In the first three months following the implementation of the Ukraine-Moldova customs procedures, Russia gave over $ 50 million in direct aid to Transnistria and another $ 150 million in credits.

Another major source of income is smuggling, typically in the form of re-export schemes. Typically, goods arrive at the nearby Ukrainian ports of Odessa and Illichivsk marked with Transnistria as their final destination, thereby avoiding Ukrainian customs duties. They are shipped to Transnistria by road or rail but soon after their arrival are re-exported to Ukraine or across the internal border border to Moldova. Because the re-export is done illicitly, across fields and rivers or by bribing the border guards, the importers avoid paying Ukrainian or Moldovan import duties and the value added tax (VAT), thus generating large profits.

Illegal importing is extremely costly to the Moldovan government. For example, EUBAM has recently calculated that as a result of chicken meat smuggling, the Ukrainian budget suffered a potential loss of up to EUR 43 million from October 2005 until May 2006 through the evasion of taxesand the potential loss to the Moldovan budget close to EUR 18 million.

Source: Excerpts from Moldova's Uncertain Future, Europe Report, No. 175 - 17 August 2006, International Crisis Group and Crisis Group interview, EUBAM, Odessa, May 2006, own calculations.

The European Commission held technical meetings with Moldova and Ukraine in 2003-2004. The main issues discussed were the recognition by Ukraine of the new Moldova customs stamps, the demarcation of the common border, and the introduction of joint border controls between Ukraine and Moldova, including along the Transnistria section of the border. On March 23, 2005 the European Council appointed a European Union Special Representative (EUSR) for Moldova (see Annex 2 on the mandate of the Special Representative). Moreover, the European Commission Border Assistance Mission (EUBAM) to the Republic of Moldova and to Ukraine was launched on November 30, 2005. The Border Assistance Mission has a two-year mandate, which may be extended.

All of these initiatives, coupled with the actions of Moldovan and Ukrainian authorities, resulted in a number of policy changes and declarations. (see Appendix 3 for details).

Moldova has been improving control over its territory with the use of the following instruments:

- Extending Moldovan customs control and boosting customs capacity over the entire Moldova-Ukrainian border that should help prevent smuggling, trafficking of people, proliferation of weapons and customs fraud. It will also help to increase revenues to the central budget.
- Enforcing the exchange of information between Moldovan and Ukrainian border controls.
- Economic agents from Transnistria that want to export to the EU and obtain certificates of the rule of origin are obliged to register in Moldova (Chisinau). The Moldovan government restricts the right to issue the certificates to those companies that are transparent in their activities.
- On the other hand, the companies from Transnistria are guaranteed not to pay double local taxes (one in Chisinau and one in Transnistria).

To date, the following effects of the common actions (EU-Moldova-Ukraine) were achieved:

- Moldovan authorities introduced simplified procedures of provisional registration of Transnistrian economic agents and enterprises with the State Registration Chamber and committed themselves to reimburse the fees to Transnistrian companies operating with Moldovan customs procedures. Currently, 237 Transnistrian companies have been registered in Moldova, out of which 125 companies have temporary registration and 112 companies have permanent registration.
- From February-October 2006, the Chamber of Commerce and Industry (CCI) issued 2,625 certificates of origin and export licences, including 768 preferential certificates of origin of goods. 53 out of 237 Transnistrian economic agents registered at the Chamber of State Registration of the Republic of Moldova (CISRM) and requested certificates of origin of goods, and 12 economic agents received 2,036 certificates of origin of goods. Two-thirds of the total certificates issued by the CCI belong to four economic agents: Tirotex, Vestra, Moldovan Ironworks, and an electrical devices plant from Tiraspol. The Customs Service of the Republic of Moldova, began issuing certificates, Form A, for export of goods to the European Union July 1, 2006 and as of September 18, 2006, 247 certificates of origin Form A have been issued to eight economic agents from the Transnistrian region, which have permanent registration at CISRM for trade with the EU member countries. 161 preferential certificates were issued to Tirotex, 20 to Vestra and 17 to Intercentru-Lux[33].
- The process of reimbursing the sums paid by economic agents from Transnistria into the Moldovan budget has been performed without delays and according to the amounts requested. From April 1 – September 21, 2006, 11 permanently registered and 8 temporarily registered economic agents from the region requested reimbursement. To date, a total of approximately MDL 11.1 million has been repaid[34].
- As a result of EUBAM, Ukrainian and Moldovan cross border cooperation throughout October 2006, resulted in a 40% increase in the number of people refused entry at the border crossing points compared with the same period of the last year, indicating tighter border control systems.
- Observers have assessed that Moldovan customs now controls nearly all Transnistrian imports and approximately 35% of its exports. The results show that the potential for tax avoidance connected with smuggling is still high[35]. However, progress is being made.

[33] News Agency Info-Prim-Neo, http://www.info-prim.md/?a=10&nD=2006/10/17
[34] News Agency Info-Prim-Neo, http://www.info-prim.md/?a=10&nD=2006/10/17
[35] By imported volumes that are higher than internal Transnistrian demand and not being matched by the appropriate registered export figures.

The plans and developments to date bring hope that Transnistria will soon cease to be considered a 'half-breakaway' region especiallyas there are no ethnic or religious conflicts between the rest of Moldova and the region. Moldova is a country with many ethnic minorities, and despite a large population of Russian speakers in Transnistria, the region is not unique and such differences should not prevent its re-integration with the rest of the country.

The EU has become more heavily engaged in Moldova and it maintains a high profile even in Transnistria. Some believe that a transformation is already under way as a result of the EU monitors on the Transnistrian border with Ukraine and the new customs procedures Ukraine and Moldova are implementing to control Transnistrian exports. Although EUBAM and the customs procedures are having a direct effect on the Transnistrian regime, they have important limitations. Thus, there are serious concerns about what will happen when the EUBAM mandate expires in 2007. As long as Russian support for Transnistria continues, it will be very difficult to break the stalemate and compel the breakaway region to normalise relations with Chisinau. The Transnistrian elite will need to decide that a future within Moldova has more to offer than one apart from it.

2.6. EU technical assistance to Moldova

Taking into account the ambitious reform agenda, Moldova's budgetary needs, its stock of debt and plans for further cooperation, it is very important that common actions are correctly prioritised and that they receive support from the European Union.

Thus far, Moldova benefited mainly from the EU TACIS Programme which is one of the main tools for developing strong economic and political relations with the New Independent States. Total EU assistance to Moldova from 1991 to 2003 amounted to more than EUR 250 million. The TACIS Programme committed around EUR 98.1 million for Moldova over the 1991-2003 periods, including national, regional and cross-border programmes. The new TACIS programme covers the budgetary period 2005-2006 and commits EUR 42 millions for assistance to Moldova.

The TACIS Programme for Moldova in 2005-2006 was focused on:

- **Institutional, legal and administrative reform:** Support to the implementation of the Action Plan and PCA implementation, and support to the implementation of the EGPRSP. In particular, TACIS will support the actions necessary to the implementation of institutional, legal and administrative reforms, as laid out in the relevant chapters of the Action Plan.

- **Private sector and economic development:** The current National Indicative Programme (NIP) supports actions to promote the development of Small and Medium size Enterprises (SMEs); privatization; support for the process of implementation of a new regional development policy with particular focus on the rural economy and rural areas; support for trade and exports promotion, including creating conditions for increasing investments, particularly for attracting Foreign Direct Investment (FDI). The financing of a European Information Correspondence Centre (EICC) in Moldova is also foreseen.
- **Alleviation of the social consequences of transition:** In accordance with the implementation of the Action Plan, the NIP will provide support to poverty reduction policies identified in the EG-PRSP and in the National Action Plan for Human Rights (NAPHR), approved by the Moldovan Parliament in 2003, through social assistance via strengthened NGOs, health and childcare[36].

Along with TACIS, Moldova has benefited from other EC instruments (Box 5), such as macro-financial aid (over EUR100 million disbursed so far), humanitarian assistance (EUR5.6 million until 2001 and then phased out), food security programme (EUR35 million committed until 2006), and the initiative for democracy and human rights (EUR1.7 million until 2000 and then phased out).

Table 16. EU assistance to Moldova in 1991-2003

	1991	1992	1993	1994	1995	1996	1997	1998/	1999	2000/	2001	2002/2003	Total
TACIS Action Programme	1.0	9.0*		10.0	9.0	13.1*		14.7*		14.8 +1.5Res		25.0*	98.1
Small Projects Programme						4.9		4.8		4.7			14.4
Inter-State Programme													
Cross Border Co-operation Programme						2.0	2.7	1.3	0.7	4.0	3	3.7	17.4
Macro Financial Assistance		27.0**		25.0	20.0	15.0						15.0	102.0
Food Security Programme										5.5		10.4	15.9
Humanitarian Assistance									3.9	0.8	0.8		5.5
Total	1.0	36.0	0	35.0	29.0	35.0	2.7	20.8	4.6	31.3	3.8	54.1	253.3

* Financial planning is bi-annual
** Grant
Source : http://ec.europa.eu/comm/external_relations/moldova/intro/index.htm

Moldova has also benefited from bilateral assistance from EU member states. The most important donors include Denmark, Germany, the Netherlands, Sweden and the United Kingdom. Moldova also benefits from the technical assistance of Romania. Other donors active in Moldova are the International Monetary Fund (IMF), World Bank, US Agency for International Development (USAID), European Bank for Reconstruction and Development (EBRD), Japan, the United Nations Children's Fund (UNICEF), the United Nations Development Programme (UNDP), and the Soros Foundation.

[36] EU Country Strategy Paper 2004-2006, National Indicative Programme 2005-2006 Moldova, page 3-4

At present, the TACIS regulation is due to expire at the end of 2006 and the Commission services are currently in the process of devising proposals for a new concept and regulation. The new program will be the European Neighbourhood and Partnership Instrument (Box 5), which will bring coherence to the delivery of Community assistance to all countries covered by the ENP plus Russia. The ENPI will replace existing TACIS, MEDA and a number of other thematic programs. It will also replace the cross border cooperation programmes financed by TACIS, MEDA and Interreg.

A specific and innovative feature of the ENPI is its cross border cooperation component. Under this component, the ENPI will finance the 'joint programmes' bringing together regions of EU Member States and partner countries sharing a common border. This will bring a radical simplification in procedures and substantial gains in efficiency. It will use an approach largely modelled on EU structural funds principles such as multi-annual programming, partnership and co- financing, adapted to take into account the specificities of external relations. The cross border component of the ENPI will be co- financed by the European Regional Development Fund (ERDF).

The European Council adopted a regulation establishing, and laying down general provisions for a European Neighbourhood and Partnership Instrument for 2007-2013, following an agreement reached with the European Parliament. The regulation establishes a legal framework for the provision of Community assistance to support the EU's European neighbourhood policy. A total of EUR 11.181 billion over seven years will be provided from the Community budget for implementation, of which at least 95% will be allocated to country and multi-country programmes, and up to 5% will be devoted to cross-border cooperation programmes. The regulation will begin application on January 1, 2007[37]. The priorities for granting EU assistance will be assessed on the basis of the provisions of the action plans.

In the context of the new assistance programs, the Republic of Moldova could also benefit from the Structural Funds for Infrastructure Development, Technical Assistance Exchange Unit (TAIEX) and Twinning Programs, as mentioned by Action Plan and, possibly the Special Accession Programme for Agricultural and Rural Development (SAPARD). Even if these Programmes are designed for accession countries, the prospect of 'a stake in the internal market' of the Union shall designate these programs for the Eastern neighbours as well[38].

However, it is important to note that a large amount of funds can now be transferred through the ENPI and that the ENPI introduces an element of competition between the beneficiary countries. This is to say that more aid is to be awarded to the best performing reformer and the competition is stronger than under

[37] Press Release of the Council of the European Union, "Council approves financing instrument to provide more than EUR 11 billion for European Neighbourhood Policy, Luxembourg, 17 October 2006 14087/06 (Presse 292).

[38] For an overview of the EU Assistance Programs, Börzel and Rise, "One Size Fits All", 2004.

Box. 5. Principles of the European Neighbourhood and Partnership Instrument (ENP budget)

The European Community assistance will be used to support measures which pursue one or more of the following objectives:

- Promoting political dialogue and reform;
- Promoting legislative and regulatory approximation in all relevant areas and, in particular, to encourage the progressive participation of partner countries in the internal market and the intensification of trade;
- Strengthening of national institutions and bodies responsible for the elaboration and the effective implementation of policies in areas covered in the Partnership and Cooperation Agreements, Association Agreements or other future comparable agreements;
- Promoting sustainable development;
- Promoting environmental protection and good management of natural resources;
- Supporting policies aimed at poverty reduction;
- Supporting social development and gender equality, employment and social protection;
- Supporting policies to promote health, education and training;
- Promoting the development of a market economy, including measures to support the private sector, encourage investment and promote global trade;
- Promoting cooperation in the energy, telecommunication and transport sectors;
- Providing support to actions aimed at increasing food safety for the citizens, in particular in the sanitary and phyto-sanitary domains;
- Ensuring efficient and secure border management.

Source: Proposal for a Regulation of the European Parliament and of the Council laying down general provisions establishing a European Neighbourhood and Partnership Instrument, pages 14-15.

the TACIS programme due to greater geographical coverage. Thus, in order to attract aid funds, Moldovan authorities should focus on the effective implementation of the commitments of the Action Plan.

2.7. Summary

The new European Neighbourhood Policy and the EU- Republic of Moldova Action Plan reinforced the relations between the European Union and Moldova. It brought a new dynamic to the bilateral dialogue and opened up new cooperation perspectives. Also, it allowed for clearer prioritisation of short-term goals and for monitoring of the reform progress in Moldova. This should help in bringing the Moldovan economy closer to EU standards, and in this way support economic integration.

There has also been an intensification of trade links between the EU and Moldova in recent years, although the year 2005 did not bring the expected increase in mutual trade flows. However, although the introduction of additional asymmetric trade preferences by the EU (GSP+) can support a boost in Moldovan exports, figures suggest that much remains to be done regarding the reduction of non-tariff barriers to trade with the EU.

Mutual or even trilateral cooperation for resolving the issue of Transnistria brings hopes for more internal stability in the near future, as well as for establishing conditions for economic growth and the fight against poverty. Within the last year, the Special Representative for Moldova was assigned, and the results of the work of the European Commission Border Assistance Mission are very encouraging and call for the prolongation of the Mission's mandate.

The new EU financial perspective of 2007-2013 means that more funds can be transferred in the form of technical assistance to Moldova soon. However, as these funds are based on the provisions set out in the action plans, and are conditional on domestic reforms and adherence to the EU standards, the Moldovan authorities should focus on prioritising the long- and medium-term needs of the economy, and work efficiently on implementing the assumed commitments.

Chapter 3. Implementation of the economic articles of the Moldova-EU Action Plan

This section of the report analyses progress in the implementation of the economic provisions of the EU-Moldova action plan. We have tried to cover all the major areas: increase in welfare, social and fiscal policies, trade liberalization, competition policy, financial intermediation, privatisation, and public procurement. The analysis of each subsection starts with the provisions of the action plan and then gives an assessment of the degree to which these provisions have been met. These are summarised in the bracketed comments alongside each section heading.

3.1. Increase in welfare

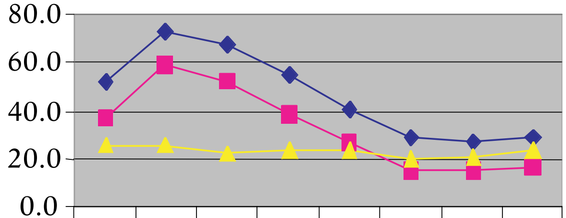
The Action Plan calls for significant steps to address poverty, notably by improved targeting and effectiveness of social assistance.

Address poverty (slight improvement)

The state policy in the field of poverty reduction is based mainly on the implementation of the Economic Growth and Poverty Reduction Strategy (EGPRS) for 2004-2006, approved in 2004. Its implementation broadly follows the Action Plan and it was recently extended to 2007. Increased spending on health, education and social protection is reflected in the budget from previous years. (See section 1.2).

Also, there has been improvement in the efficiency of the social assistance system that focused on the addition of a social assistant in the structure of the mayoralties of villages (communes) and cities (municipalities) and the development of regulations for social-medical services provided at home for the elderly and people with disabilities.

Figure 6. Poverty indicators, 1998-2005



	1998	1999	2001	2002	2003	2004	2005	2006
absolute	52.0	73.0	67.8	54.6	40.4	29.0	26.5	29.1
extreme	37.4	59.7	52.2	38.0	26.2	15.0	14.7	16.1
relative	25.8	25.4	22.3	23.7	23.6	19.4	20.3	23.3

Source: Ministry of Economy and Trade.

It seems that the expenditures had some effect and contributed to higher incomes and improved access of the population to social services, which led to higher living standards and poverty reduction, at least until the end of 2004. However, although it is worrisome that a slight increase in poverty indicators in 2005 was observed, concrete conclustions on whether the policies continued to improve the situation or whether there has been reversal in the poverty reduction trend, can not be drawn until more evidence is provided in the coming years.

3.2. Social and employment policy

The Action Plan defines some general recommendations for social policy. In particular, it recommends strengthening the dialogue and co-operation on social matters, and ensuring a closer approximation of the country to EU standards and practices in the area of employment and social policy.

Labour market (slight improvement)

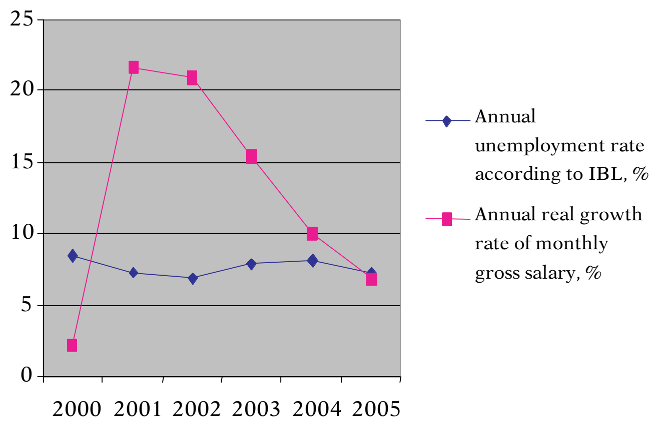
As for employment, the following measures were undertaken to adopt advanced European practices, aiming at increasing the employment level and reducing the impact of unemployment:

- Local networks of territorial agencies for employment were created and are operating;

- A central network of the National Employment Agency and the archive centre were also established and began functioning.

These changes should help in increasing the access to information on vacant jobs, although it should be noted that the process is still in its early stages.

Figure 7. Unemployment rate and growth of salaries, 2000-2005



Source: IMF.

A number of international conventions in the field of labour were ratified by the Moldovan Parliament. These conventions should benefit the Moldovan workers employed abroad. The legal framework was also improved in the field of gender policy in order to ensure equal opportunities for men and women in society and business.

The system of social protection of the unemployed was improved with new categories of people eligible for unemployment benefits and professional integration or reintegration allowances were added. Further, loans from the Unemployment Fund for the creation of new job vacancies under advantageous conditions were introduced. However, major problems remain in the pension system. The reform of the pension system is slow and the financial instability of the social security fund raises concern.

Conclusions

In order to improve the financial sustainability of the social system it is important to continue the reform in the pension system by strengthening the link between contributions and benefits. Also, work should continue in implementing the individual accounting system of state social insurance contributions by the integration of data on contributions in the Social Fund database. The progress in facilitating access to labour market, as well as in the protection of unemployed is satisfactory.

3.3. Sustained growth, consolidated public finances and public debt

The Action Plan states that vital steps toward sustained economic growth and macroeconomic stability are to:

- adopt a comprehensive medium-term expenditure framework (MTFF), integrating the central government budget, the local government budgets, the public social insurance budget, extra-budgetary funds and external financial assistance;
- make progress in reducing the burden of excessive public debt, in particular foreign debt;
- take concrete steps to improve public expenditure effectiveness, transparency and accountability;
- ensure full compatibility of the EGPRSP (growth and poverty strategy) within the medium term expenditure framework.

Public finance sustainability (significant improvement)

The objectives of fiscal policy were developed as part of the medium-term expenditure framework (2007-2009). These objectives are oriented towards ensuring stability and predictability of collection of revenues, promoting fiscal equity and stimulating economic growth. The current MTEF is characterized by better strategic planning of public expenses with additional inclusion of the agricultural sector. Also, local public authorities are more involved in the planning of budgets. The allocation of resources within the MTEF for the years 2007-2009 was done by analysing expenditures and resources of particular sectors of the economy.

Significant progress was achieved in the review and completion of fiscal legislation, by which the objectives of Fiscal Policy and of Fiscal Administration Policy for 2007 were to be accomplished. The existence of the Communication Strategy in the field of MTEF and of the annual budget can be considered a positive change and will increase the transparency and enhance broader participation in the budget planning through better dissemination of information.

In the field of Public Internal Financial Control, two draft-documents were developed and coordinated with the relevant authorities, the Concept of the Internal Financial Control and Strategy of the Internal Financial Control.

Training in the the new system of internal financial control and auditing was provided to national experts. However, cooperation with the relevant EU institutions must be enhanced in order to achieve a higher level of approximation.

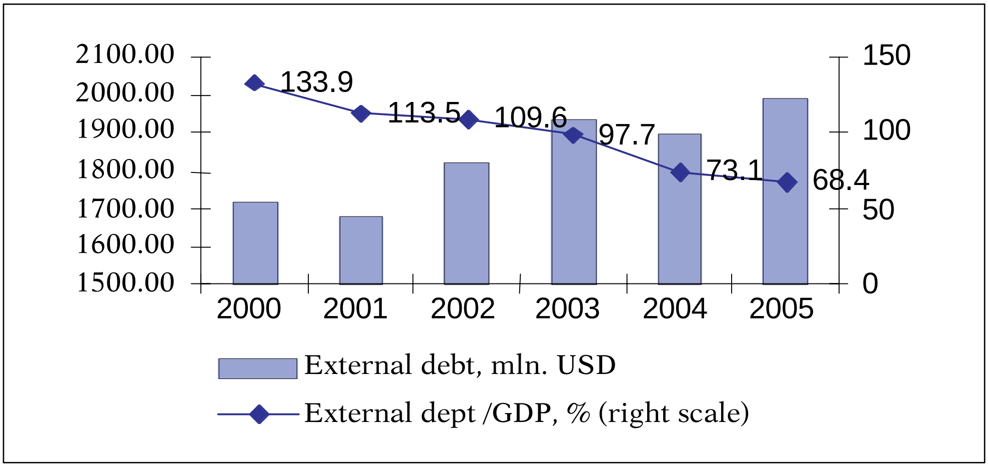
Public debt (worsened)

As for state indebtedness, the legislative framework of public indebtedness was revised for the adjustment to the European and international standards; as a result, a new law was developed and approved in August 2006.

Progress was achieved in repayment of state debts:

- debt repayments were initiated to the National bank of Moldova (NBM),
- the Paris Creditors' Club accepted a restructuring plan, decreasubg debt from USD 149.9 million to about USD 60 million of Moldovan public external debt. The conclusion of this agreement is a continuation of the approval by the IMF of the new arrangement for the implementation of the Economic Growth and Poverty Reduction Program in Moldova.

Figure 8. External debt, 2000-2005



Source: National Bank of Moldova.

From February to September 2006, the Council of Creditors signed new restructuring agreements for a total amount of MDL 97.33 million. However, new debt has been accumulated due to new borrowings in the private sector. As a result, external debt increased in nominal terms in 2005 (Table 5).

Tax policy (progress)

The Moldovan Parliament passed the fiscal policy for 2006, which introduced new major additions to the Tax Code, from the viewpoint of both local and international experience.

An important harmonization, relative to the legislation in force throughout the world, is the new definition and the exact scope of the "representative office" and "permanent establishment" concepts, which were previously very poorly regulated by the Tax Code. Another important feature is the introduction in the Tax Code of basic taxation principles, such as neutrality of taxation, certainty of taxation, fiscal equity, fiscal stability, and tax efficiency. The recently adopted fiscal policy aims to encourage new investments by alleviating the tax burden. Thus, there have been significant changes in the corporate income tax and individual income tax. The corporate income tax rate for 2006 is 15% and the maximum tax rate for individuals is 20%.

An important new development is the improvement of tax provisions with respect to non-residents. Thus, provisions on taxation of non-residents were included in a separate chapter, which contains specific regulations regarding the breakdown of non-residents' income depending on the earning source (i.e. within Moldova or abroad) and income taxation rules for non-residents that do not perform an economic activity in Moldova through a permanent establishment. Further, regulations were established for those non-residents that derive income from resident individuals and for those performing construction site activities, as well as rules applicable for those performing economic activities through a representative office in the Republic of Moldova.

As regards the indirect taxes, the fiscal policy provides for an 8% VAT rate on drugs imported into Moldova (such items were previously VAT-exempt) and an increase in the duty rate on certain excisable goods. At the same time, gambling has been exempt from excise duties.

In the coming year, a number of legislative initiatives were developed that will amend several provisions of the Fiscal Code and the Law on Customs Tariff. The amendments refer to the VAT, tax administration, and creating new tax incentives for reinvested profits. Also, the Parliament ratified 17 agreements on mutual protection of investments and prevention of double taxation, including agreements with seven EU member states and five Balkan countries at various stages of EU integration.

Conclusions

The full implementation of the agreement with the IMF is the major goal for the medium-term period. Further pursuit of fiscal discipline is needed in order to avoid macroeconomic instability and rein in inflationary pressures. The most important issue at the moment seems to be a reduction in the recently accumulated debt stock.

Improvement is needed in public finance management and transparency, and in further developing the MTEF. Also, there is a clear need to implement the framework for internal auditing within the public sector.

Progress has been noted in the reform of the tax system and new legislative proposals have been drafted. However, there is a need to further improve transparency and equitability of the tax system, to broaden the tax base, in particular through a gradual elimination of tax exemptions, and to strengthen the tax collection and control systems. The tax legislation does not fully conform to WTO norms and commitments or with the principles of the EU Code of Conduct on business taxation.

3.4. Monetary and exchange policy

The action plan refers to monetary policy in the context of enhancing monetary stability and in this view, monetary policy should concentrate on combating inflation.

Monetary and exchange policy (worsening)

The monetary policy of the country has been nominally oriented towards achieving the primary objective of internal and external national currency stability. In effective terms, the National Bank of Moldova has followed a de facto peg since 2004, but allowed for some easing of the pressures on the exchange rate as a result of the large inflow of remittances. However, even though the interventions have been sterilised, they have not prevented the money supply from growing, which in turn fuelled inflation[39]. As a result, the yearly average inflation rate was over 10% in 2005 (Figure 9), and in the first quarter of 2006, it had increased to 16.6% yoy.

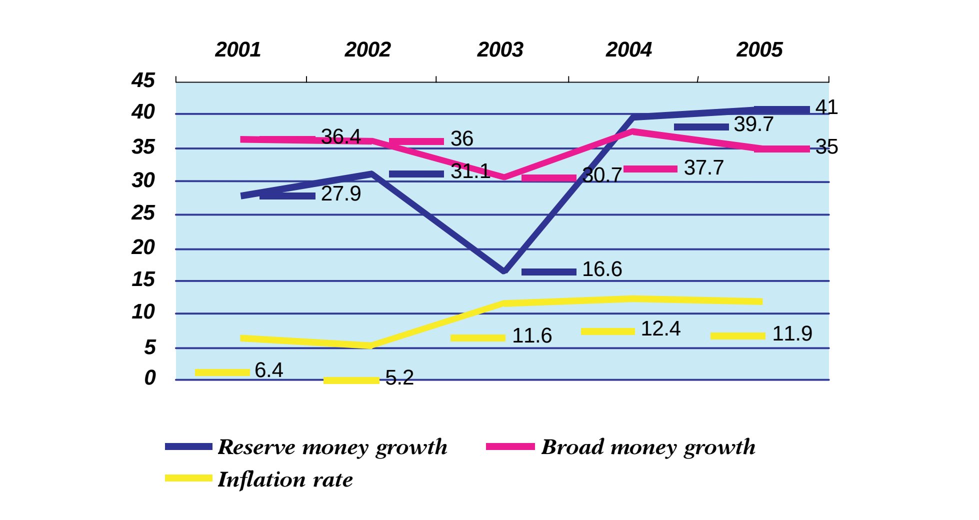
In order to continue improving the legal framework on the tools of the monetary market and adjustment to EU standards, the National Bank received external technical assistance for the implementation of the monetary market tools in 2005. Currency regulation legislation is currently being developed taking into consideration EU experience and requirements.

The IMF suggests that the National Bank of Moldova should focus on inflation targeting, as it is predicted that in the near future the likely effect of remittances on the exchange rate will be offset by higher energy prices.

Nevertheless, the domestic financial market is so small that it would be difficult for the NBM to sterilise the effects of its interventions[40].

[39] After IMF Moldova country report No. 06/184.
[40] IMF (2006), p. 20.

Figure 9. Monetary indicators, 2001-2005



Source: IMF.

As a result of these suggestions, the Law on the National Bank of Moldova was amended and approved by the Parliament in 2006. The law clarifies that monetary policy aims at maintaining price stability and strengthens the independence of the National Bank of Moldova.

3.5. Functional market economy

The EU-Moldova Action Plan lists the following measures to be taken to establish a fully functioning market economy in Moldova:

- take measures to improve convergence in key areas of Moldovan legislation to EU legislation;
- ensure that basic regulatory bodies are fully operational;
- streamline administrative requirements for companies;
- examine and implement best practices on consultation and notification of economic operators on new regulatory measures (transparency) and ensure sufficient time for adaptation to these new regulations (predictability) of business.

Regulatory reform (improvement)

The 'guillotine' law adopted in 2004 sets up the necessary principles and actions for the review of the existing normative framework in order to remove regulations that do not correspond to the legislation and represent obstacles for businesses.

The government also reviewed relevant normative and legislative acts and excluded those which are not in line with the principles of the market economy. Also, a working group comprised of different actors in the Moldovan economy was set-up to ensure the continuity of the process. In the same context, all new legislation will be accompanied by a Regulatory Impact Assessment, which should contribute to better targeting of the developed normative and legislative acts.

Conclusions

The Government must concentrate on taking decisive steps to reduce over-regulation, in particular, to improve the transparency and predictability of the regulatory mechanism and to further reduce the burden of inspection regimes.

3.6. Privatisation programme

Article 21 of the Action Plan stipulates the following activities related to the privatization process:

- continue to improve the interface between Public and Private sector in line with World Bank recommendations;
- accelerate and increase transparency of the privatisation programme, covering large scale privatisation in key sectors in particular.

Privatisation programme (little progress)

Little progress is visible since 1998, highlighting the difficulties encountered by both large and small-scale privatisation (see in chapter 1). To ensure continuity of the privatization process in 2006, the Privatization Programme was extended until December 31, 2006. The modifications and completion of the normative acts related to the application of privatization methods were developed and approved. Amendments were made to the Regulation of the Ministry of Finance regarding the responsibility for financial reporting and monitoring of state enterprises and corporations where the government holds more than 51% of outstanding shares. The results of the analysis undertaken in 2005 were included in the budget documentation of the budget draft for 2007.

The legal framework was adjusted by introducing provisions for the implementation of the corporate governance principles within state enterprises and the government is developing a law on public and private partnership.

The government approved and promoted legislation amendments under which the state will sell 50+1 shares in electricity distribution and generation undertakings. However, the last international tender for privatizing power sector companies was held in 2002.

Conclusions

It is hoped that the privatisation process will begin again in the near future. Efforts should be directed towards full adherence to the new legislation and, in this context, the law on the management and denationalization of public property should be adopted as well.

3.7. Establishment and operation of companies

The major requirement of the Action Plan in the area of company law is creation of a favourable environment for company establishment and nondiscrimination between foreign and domestic companies. In particular, the provisions of Article 31 are to:

- abolish barriers to the establishment of companies and the discriminatory measures affecting foreign investment;
- ensure effective functioning of adequate administrative structures facilitating establishment;
- ensure effective implementation of key principles on company law, accounting and auditing in relevant international and EU rules and standards;
- ensure effective functioning of the public register of undertakings and the publication of certain information;
- adopt and ensure effective implementation of a code on corporate governance.

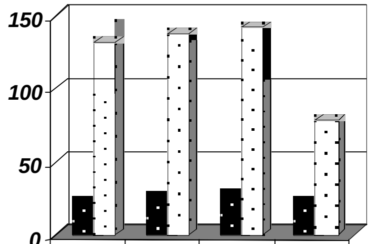
Company Law (improvement)

A number of measures have been taken to improve the legal environment of business operations. In the field of company law, a number of amendments have been proposed in order to simplify administrative procedures and to bring the national legislation in line with international requirements.

A new draft law on limited liability companies was developed and publicly discussed. Compared with the current framework, the proposed legislation advances in such areas as minority participants' protection, corporate governance, and validity of agreements concluded. Meanwhile, the Code of Corporate Governance has been developed with technical assistance provided by international donors.

In order to improve the business climate, the reform of compulsory registration of entrepreneurship activity was initiated. Its goal was to reduce the level of dependency of enterprises on administrative decisions and to reduce financial and time expenses borne by enterprises for licenses, authorizations, and permits, including expenses related to paid services provided by supervision and control bodies. In 2005, the 'one-stop-shop' principle was introduced for the process of issuing entrepreneurship activity authorization documents. As a result, the number of days spent registering a company and registration costs fell in 2005.

Figure 10. Registration procedure, 2002-2006



	2002	2003	2004	2005
Registration timing, days	23	26	28	23
Registration costs, USD	132	137	142	78

Source: Cost of doing business in Moldova, WB, 2006.

Further, the amendments and completions of the Patent Law were approved. The amendments aim at reducing the cost of a patent by 30%, which does not ensure the minimal contribution of compulsory state social insurances and the establishment of the liability of the patent holder to pay the social insurance contributions seperately. Thus, a clear and transparent system of tax and duty collection was established and the existing overlap in the activity of the Territorial Fiscal Inspectorate and the National House for Social Insurances was eliminated. The result should provide for easier development of innovative companies.

As discussed in section 3.3, there have been changes in the tax law regarding income taxation of non-residents As a result, the situation of foreign companies vis-à-vis domestically-owned companies became more stable, creating equal conditions for operations, regardless of the origin of the company.

SMEs development (good progress)

At the beginning of 2004 the Republic of Moldova, together with 34 other countries, committed itself to achieve the fundamentals of the European Chart for Small Enterprises. As a result of the action plan on the participation of our country in the process of the Chart implementation, the annual country reports were developed concerning the achievement of the Chart, in which the progress of Moldova was presented. The National Strategy for SME development and the Strategy to Support the Development of Small and Medium Sized Enterprises 2006-2008 were adopted. Also, the regulatory and fiscal framework for SMEs has been improved. The business registration process was simplified and accelerated; the number of inspections to which the SMEs are subject has been considerably reduced; the fiscal reporting responsibilities of SMEs have been eased.

The draft law on supporting the small and medium enterprise sector was developed in 2006. The law puts the small business classification criteria in compliance with the recommendations of the European Commission, introducing at the same time the notion of the medium enterprise. The new law establishes a new procedure of qualifying an entity as a subject of the small and medium enterprise sector on the basis of the declaration on its own liability. The law defines the institutional framework supporting the small and medium enterprises and eliminates the legislative gap by which local enterprises with foreign investments were not able to benefit from the facilities offered by the state to small and medium enterprises.

Industrial policy (some progress)

A new Industrial Sector Development Strategy has been drafted. In line with the Moldova-EU Action Plan and in order to stimulate the privatization and restructuring processes of the industrial sector, there are 11 joint stock companies in the process of insolvency, of which 1 is occuring through reorganization, and 10 through bankruptcy, two of which are state enterprises.

With the view of establishing a permanent dialog on industrial policy, negotiations concerning the cooperation agreements in industry with 12 countries from the EU and participants in the Pact of Stability for South-Eastern Europe were initiated. This reflects Moldova's efforts towards deeper integration into the EU policy framework. The next 16 agreements of this kind are expected to be signed with external partners in 2006. The agreements create a stimulating normative framework of collaboration in light industry, engineering, electronics, chemicals, and the furniture industry.

Moldovan authorities are now trying to elaborate technical regulations for certain products in line with the requirements stipulated in the European directives.

The EU experience, regarding the functioning of the industrial/innovative parks has been examined and it is now applied, with the corresponding legislative acts currently being drafted.

Conclusions

The number of days needed to register a company and the associated costs fell in 2005 as a result of actions taken in the sphere of administrative processes. This is clearly a welcome outcome. The government should now concentrate on the broader use of the elements of the 'one-stop shop' procedure in order to facilitate the system of granting permits for entrepreneurs. Also, further efforts can be directed towards improving the system of exchange of electronic data by the public administration.

Another area that can potentially bring beneficial results regards the easing of procedures required for business closure. Action should be taken to decrease the time and reduce to a minimum the need for businessmen to present certificates and other documents in order to close a business.

There have been steps taken towards the support of SME development and some, although limited, improvements in the field of industrial policy have been made. However, it should be remembered that all Moldovan companies would benefit from better and more transparent general regulations. In this view, the authorities should concentrate on further adoption of EU technical standards and the improvement of auditing and accounting standards. This would allow firms to be more internationally competitive.

The country also needs more foreign investment which would help in further restructuring and modernising the economy. Therefore, Moldova should further improve its dialogue with foreign investors by addressing the concerns of the Foreign Investors Association recently expressed in their 'White Book'[41].

3.8. Trade-related issues

In the area of international trade, the Action Plan refers mostly to Moldova's WTO commitments and envisages the fulfilment of all of its obligations as a full member.

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[41] White Book contains proposals for improving the investment climate in the country., recommendations how to remove the barriers standing in the way of direct investments in country's economy, simplification of state control and continuation of the regulatory reform.

Implementation of the WTO commitments (good progress)

Up to the present there was no evaluation of the fulfilment of Moldova's commitments, although some tangible results have been achieved:

- The market access commitments of goods have been realised, meaning that all tariffs have been bounded. A four year scheme for gradual reduction was in principal accomplished (2001-2005). No special safeguard measures and tariff quotas are applied. Generally speaking, as a developed country, Moldova has undertaken strong commitments such as relatively low simple average *ad valorem* final bound duties (2005), including duties on sensitive products such as white sugar, beef, and pork. The duty on industrial products is currently 6% and 12.2% for agricultural products.
- Very liberal horizontal commitments have been undertaken in the service sector, with commitments in 148 of 165 sub-sectors, approximately 131 fully liberalised sub-sectors in the first 3 modes of supply and there are a limited number of MFN exemptions. Several achievements were realised in the telecommunications sector, including improved interconnection arrangements and tariffs, the entering of a number of small alternative fixed-line operators, and competition in the mobile and Internet sectors. A big issue is still the privatisation of Moldtelecom, which was not even included in the list of enterprises to be privatised in the near future.

In 2007, the WTO will carry out the first Country Trade Policy Review Paper for the Republic of Moldova. In this context, the government is preparing the country profile on the implementation of its commitments under the WTO.

Moldova's trade policy (significant progress)

In general, Moldova has a fairly liberal trade regime, but there are still informal restrictions on exports of some key commodities, including wheat and sunflower seeds. In addition, inefficient and costly border procedures are a significant impediment to businesses wishing to conduct trade operations. Moldova has an open economy, liberalised trade and no export subsidies. The efficiency of customs procedures is impeded by delays in adopting secondary legislation and insufficient administrative capacity. Further, there is an ongoing conflict concerning customs control on goods from the region of Transnistria.

The Investment Attraction and Export Promotion Strategy for 2006-2015, which was approved in October of 2006, is considered to be a positive step in the process of attracting new FDI and diversifying Moldova's exports, especially given the current situation regarding Russia's ban on imports of Moldovan wines and some agricultural products[41].

Also, the anticipated granting of Autonomous Preferential Trade preferences by the EU will facilitate access of Moldovan products to the very attractive EU market. The first steps towards the implementation of these trade preferences have been completed. The list of goods set to receive the ATP preferences has been submitted to EU and, in order to ensure an effective control of the origin of goods, the responsibility for issuing and verifying the certificates of origin was transferred to the Customs Service. The national system of rules of origin was adjusted to the European Union requirements. As of July 2006 the Customs Service is the official institution responsible for issuance and control of the certificates of origin, Form A, as required by the EC services.

Moldova's regional cooperation in South-Eastern Europe, especially within the Central European Free Trade Agreement (CEFTA), could facilitate its regional economic integration and promotion of Moldovan products in the regional market.

Implementation of customs legislation aligned with international and EU standards (progress)

The legal framework of customs was amended in order to correspond to EU requirements. New amendments to the Customs Code relate to customs destinations, activity of mobile teams, principle of risk based customs control and the post clearing audit, and activity of customs brokers, among others. The Code on the ethical conduct of customs workers was adopted and it is hoped that it will help fight corruption in the Customs Service.

According to legislation amendments, the structure of the customs service was changed in order to accommodate new units, which will fulfil the newly attributed functions. All of the necessary equipment and training was provided through technical assistance of the EU.

An important achievement in this field has been the ratification of the International Convention on Harmonised System for description and codification of goods, signed in Brussels 1983. Moldova is the first country to implement the new version of the Asycuda World program.

In the context of implementing the modern principles of customs activity based on the simplification of procedures, selective control, and efficient collaboration with the business community and citizens, the government has raised the amount of currency that may be taken out of the country without presenting any justifying documents and without declaration.

[42] It is expected that the document's successful implementation would result in an annual growth of direct foreign investment by 10% and exports by 10-15%, as well as in a constant enlarging of the export commodity assortment and of sale markets.

Standards and technical regulations (weak progress)

Thus far, little progress has been made towards transferring from a mandatory to a voluntary system of standardisation. Recently, a strategy for the creation of a quality system in Moldova, 'Metrology, Standardization, Testing, Quality' (MSTQ), has been elaborated with the support of the World Bank and is to be approved by the government. The Ministry of Economy and Trade and the Standardization and Metrology Service (SMS) initiated the development of the technical regulations programme. The programme covers specific regulations, responsible institutions, international and European normative acts, if appropriate, on which the development of regulations will be based, and a deadline for the regulation to be drafted.

Currently, the Moldovan quality assessment system is not recognized by the EU, yet it is recognized by the CIS and Romania.

The main issue in the field of quality assessment is that many of the certification bodies are owned by the ministries that at are charged with regulating their respective areas. Moreover, some ministries have the right to control and supervise enterprises in their field, which is obviously a conflict of interest. Also, the SMS has several certification bodies under its jurisdiction that still carry out some inspection functions.

Moldova does not have a market surveillance system and instead uses state control and supervision. It is carried out by numerous state organizations, and thus is a considerable burden to business development. However, some steps have been made by the government to improve the conceptual and legal framework in the sector.

In order to approximate the Moldovan standardisation system with the EU and the international system, some of these European (EN) and International (ISO/CEI) standards were adopted as Moldovan, while others were adjusted to correspond to the specific national situation.

A special attention is given to revival of enterprise competitiveness, according to international standards, through continuous improvement of managerial practices, implementation of the quality management systems (Sector Programme 'Quality' for 2004-2008), as well as the development, implementation and certification of quality management systems, in line with ISO 9000.

In the field of consumer protection, little progress has been made, but there are plans to amend the legislation in this field. Currently, there is no national plan for consumer protection and only one consumer protection association is active. As for the institutional framework, the responsible laboratories are poorly equipped and the inspectors do not have the means to perform proper tests.

In the field of conformity assessment, the national legislation was approximated with EU procedures and rules for applying the conformity assessment trademark. This will eventually facilitate the adjustment of the mechanism of insuring the conformity of Moldovan products with international standards and will simplify the procedure of the conformity certificates issue.

Sanitary and phyto-sanitary measures (some progress)

Moldova is now a member of the International Organization for Epizootic Diseases (OIE), which means that legislation and monitoring tools, that will ensure the control of a wide range of animal diseases, are required. Notwithstanding, the comments above concerning Moldovan and EU food law in general, it is clear that the responsibilities attached to Moldova's membership in the OIE are already being addressed. Similarly, Moldova is already working closely with the EC Food and Veterinary Office in order to establish the appropriate standards for exports of animal-based products to the European Union. A detailed programme of harmonisation of national veterinary legislation with the EU Veterinary Aquis was presented to DG Sanco, covering the adoption of some 30 pieces of EU legislation.

Conclusions

The developments thus far show that Moldova has made good progress in adhering to its WTO commitments in the spheres of both goods and services. Moreover, the efforts of Moldovan authorities in applying for EU Autonomous Trade Preferences are worth noting. All of these activities will help in gaining access to the EU market and therefore in the diversification of Moldovan exports and the general development of the economy.

The progress in customs services thus far can be judged as satisfactory as demonstrated by the tighter control of the Moldova-Ukraine border in 2006. However, further steps are needed and it is crucial that the new rules and procedures are effectively adopted.

Unfortunately, little progress has been made up on the issue of standardisation and testing. Effort should be put towards the creation of appropriate certification bodies. If established and functioning, they will improve competitiveness of Moldovan exporters vis-à-vis firms already active in the EU market.

3.9. Movement of capital

Repatriation of capital (progress)

Regarding the movement of capital, the action plan requires free movement of capital relating to direct investment, protection of foreign investments and the liquidation and repatriation of profits and capital.

Since Moldova accepted Article VIII of the IMF Charter, which required liberalization of current foreign exchange operations, there are no longer restrictions on the conversion or transfer of funds associated with foreign investment in Moldova. After the payment of taxes, foreign investors are permitted to repatriate residual funds. Residual funds transfers are not subject to any other duties or taxes and do not require special permission. There are no significant delays in the remittances of investment returns, since domestic commercial banks have accounts in leading multinational banks. Companies are not obliged to sell their hard currency earnings to the government, while foreign investors enjoy the right to transfer or use their earnings from investments on the territory of Moldova or abroad.

The Law on Investment in Entrepreneurship states that investments cannot be subject to expropriation or measures with a similar effect. An investment may be interrupted only in the event of the following cumulative circumstances: the interruption is done for purposes of public utility, is not discriminatory, and is done with just and preliminary compensation. If a public authority violates an investor's rights, the investor is entitled to reparation of damages. The compensation will be equivalent to the real extent of the damage at the time of its occurrence. The public authorities concerned will pay compensation for any damage caused, including any foregone profits. Compensation must be paid in the currency in which the original investment was made or any other convertible currency, if the investment was made in a convertible currency. Public authorities may provide investors additional guarantees.

3.10. Movement of people

Acceptance of migrant workers (little progress)

In the area of free movement of people, the Action Plan envisages abolishment of all discriminatory measures based on nationality that affect migrant workers and coordination of the provisions on social security with the EU member states. The European Convention on the Legal Status of Migrant Worker has been ratified (February 10, 2006) with the view to define and improve the domestic legislation on the issue, the management of migration process and social protection of citizens working abroad. These conventions should help to balance the conditions for the Moldovan workers employed abroad, and facilitate their movement. Draft agreements on the regulation of the migration of the labour force are under consideration of the relevant Spanish and Greek authorities The Agreement on the temporary residence of migrant workers is being negotiated with Portuguese authorities.

3.11. Financial intermediation

The list of actions related to financial market improvements includes:

- ensuring implementation of the recommendations of the IMF FSAP (Financial Sector Assessment Program);
- enhancing the prudential regulatory framework for financial markets and supervision equivalent to that existing in the EU;
- setting up and training supervisory authorities in the financial sector;
- developing an insurance market.

Financial market (modest progress)

In the field of financial services regulation, some modest achievements have been recorded. The legal framework is to be adjusted and some draft laws for this sector are currently under consideration. Also, in order to improve regulation and supervision of the financial market, there are plans to merge several existing public authorities into a State Commission for Financial Markets (the so-called Mega-regulator), which will supervise the securities market, insurance companies, private pension funds, investment funds, and credit institutions other than banks. In order to insure its independence, the Commission will not be subordinated to any ministry and its members will be appointed by the Parliament directly.

It is worth mentioning the draft Law on Credit History Bureaus, which is highly important for the banking system at large. The law is in its final stages of development and its approval will definitely reduce the risks involved in crediting. However, corresponding legislation on data protection remains to be finalized.

The financial market of Moldova is underdeveloped and shallow. The primary market for government securities is well-organized, but dominated by commercial banks, while the secondary market is almost nonexistent. The lack of equity investors is exacerbated by fragmentation of the market. In order to address these issues a package of laws is under development by the National Commission for Securities.

As a follow up, after the approval of the amendments to the Law on Financial Institutions, the National Bank of Moldova adjusted all the normative and regulatory legislation to the new prudential provisions. The amendments were related to authorizations, investments in the normative capital of legal entities, transactions with affiliated bodies, internal auditing, etc. The NBM identified the package of documents that the commercial banks must have in possession at any time in order to ensure the transparency in the structure of shareholders.

Conclusions

It is obvious that the prudential regulatory framework for financial markets must be enhanced, in particular for the banking system. Also, accelerating the development of the non-bank financial sector in Moldova, as a means of stimulating growth throughout the country, remains a high priority.

3.12. Competition policy

Alignment of competition rules to the EU policy called for broader antitrust measures amd aims to regulate the way in which companies operate. The new Law on Protection of Competition of the year 2000 achieves this objective. However, the law has been waiting to be implemented and nothing has changed since 2004. Moreover, the Agency for the Protection of Competition currently exists only on paper.

State aid and state monopolies (no change)

The Antitrust Law of 2000 fails to provide a specific chapter or paragraph for state subsidization. Further implementation of legislation may be required to identify those types of rescue packages that are justified in Western competition policies for 'one off' assistance and restructuring.

State monopolies are defined as arising from the exclusive right, awarded by public authorities, to a limited number of economic agents to carry out their activities in a given branch of production, transport, purchase or sales of commodities and services.

Private as well as public agents may engage in a range of activities listed in the Republic of Moldova under natural monopolies. An exhaustive enumeration will list railways, energy production and supply, communications, other communal services and airport facilities, air traffic control and others. The Government Decree of 1995 provides for the supervision of activities carried out under state and natural monopolies. Control is exercised by the central and local administrations. Special bodies may adopt regulatory rules and select the most adequate system for monitoring in the sectors concerned. Monopolists are expected to present the administration with all information and documentation if requested. In reality this usually does not work, and the monopolies, both state and privately owned have some informal advantages on the market.

A draft law on natural monopolies is still in the working phase in the Ministry of Economy and Trade. It has not been publicly discussed.

Conclusions

Moldova should continue to work on the alignment of its existing national rules of competition to that of the EU. Existing national legislation covers only general provisions in the field of competition and other problems remain unsolved. The Law on Competition contains regulations for the National Agency for the Protection of Competition. In theory, the Agency is the existing authority responsible for handling antitrust issues, but in reality it is still awaiting a budget and staff. Moreover, it will be an imperative for the agency to organize seminars, develop training programmes on competition law, and exchange officials, in order to broaden their experience.

3.13. Public procurement

The EU-Moldova Action Plan discusses improving the current system of public procurement through increased transparency, information provision, trainings and the strictly limited use of exceptions. It also suggests the convergence of Moldovan public procurement rules with key EU public procurement principles.

Legislation on public procurements (good prospects)

A new draft law on Public Procurement was elaborated by the National Agency on Public Procurement and was submitted for review by the government in June 2006. The new draft is transposing the Directive 18/2004 on the coordination of procedures for the award of public works contracts, public supply contracts and public service contracts. Also, the draft law corresponds to the WTO requirements and implements the principles of transparency, non-discrimination and competition.

According to the WTO requirements, Moldova became an observer to the Agreement on Government Procurement (AGP) in autumn 2000 and has initiated negotiations for membership. The Law on Public Procurement took into consideration the requirements of the AGP in terms of avoiding discrimination of foreign suppliers. The procuring entity has no right to establish any criteria, requirements or procedures with respect to the qualifications of suppliers that discriminate against or among suppliers on the basis of nationality or their citizenship (residence). Exceptions include cases when the Procurement Agency decides on the pre-selection of the participants on the grounds of certain priorities and state interests.

Public procurement practice (no change)

The practice of purchases to satisfy state needs became popular among Moldovan ministries and other governmental structures as a means to save money. However, due to delays in the payments procedure, the participation in the tenders became unattractive for foreign participants.

The system of electronic tendering for public procurement has not been set up in Moldova yet, but the establishment of a database system for availability of data and information on tendering is foreseen.

Conclusions

The new draft law on public procurement is a favourable step forward but much depends on when it is approved. If the new law is operational and used, we can talk of progress made. Thus far, it is too early to check its results. An analysis of national legislation_in the field of public procurement as regarding the implementation of the key EU principles (e.g. transparency, non-discrimination, competition and access to legal recourse) should be undertaken and the procurements system must be decentralised and made more attractive for external bidders.

3.14. Intellectual property

The Action Plan stipulates that in the field of Intellectual Property it is necessary to ensure a level of protection similar to that in the EU, including effective means of enforcement of intellectual property rights.

The State Agency on Intellectual Property (AGEPI) is a specialized Governmental body responsible for the implementation of the provisions of the WTO TRIPS Agreement and of the EU-RM Action Plan related to the protection of intellectual property rights. The Republic of Moldova is a state member to 25 international conventions and treaties in the filed of intellectual property protection. At present, the country is a member of all international treaties and agreements mentioned in article 49 (2) of the PCA that are, according to the Moldovan legal system, part of the national regulatory framework in this area. The AGEPI insures permanent monitoring of conventions and treaties in the field of intellectual property, to which Moldova is bound. Moldovan legislation is in line with the provisions of international agreements and conventions in the field of intellectual property.

The AGEPI, in cooperation with the representatives of the Ministry of Internal Affairs and of the Customs Service, is implementing the provisions related to the enforcement of intellectual property rights. Thus, the AGEPI, in cooperation with Ministry of Internal Affairs and other competent institutions, is conducting controls, ex-officio and at the request of the intellectual property rights holders, on copyright and related rights enforcement, as well as participating in the seizure and destruction of counterfeited and pirated audio-video products. According to the statistical data of the AGEPI, in 2005, 701 inspections (620 ex-officio and 81 at request) have been undertaken resulting in the seizure of 6,976 products suspected to be infringing on IP rights. It should be mentioned that in 2004, during 383 undertaken inspections, 13,500 pirated products were identified and seized. This figure could be a relevant indicator of the diminishing infringement of IP rights of market products. During the first semester of 2006, 302 inspections (284 - ex-officio and 18 - at request) have been undertaken resulting in seizure of 3,563 pirated products.

An important factor for strengthening the mandate of the authorities responsible for the enforcement of judicial norms designed to fight against counterfeited and pirated goods was the introduction of sanctions for violations and infringements of copyright and related rights, through amendments to the Criminal Code of Moldova. As a result, the number of violations and infringements of copyrights has been reduced. The Cooperation Agreements between the AGEPI, Customs Service and the Ministry of Information Development have been renewed. As well, negotiations have been initiated with a view to signing a cooperation agreement with the Ministry of Internal Affairs in the field of intellectual property protection.

According to the EU-Moldova Action Plan, the AGEPI is responsible for conducting a study on piracy and counterfeiting in Moldova. In order to carry out the study, a working group was created on the basis of the Order of the Director General of the AGEPI. The best practices of the EU Member States should be studied, and a questionnaire was elaborated and sent to various organizations and enterprises to assess the level of enforcement and observance of the copyright laws both in Moldova and in third countries. This allowed for the collection of all necessary data for conducting and realising this study.

Conclusions

Some progress has been made**.** Further efforts are required regarding the enforcement of intellectual property rights, in particular, the realisation and publication of the study on piracy and counterfeiting in Moldova. Also, the Moldovan goverrnment must increase the resources available for the enforcement of intellectual property rights.

3.15. Statistics

In order to achieve the priorities of the EU-Moldova Action Plan, amendments to the law on official statistics were proposed. The amendments were introduced to facilitate the legal framework on the regulation of entrepreneurial activities. Also, the draft of the Strategy on Dissemination of Statistics was developed and, for the first time, the information was also officially available in electronic format.

The National Bureau of Statistics, together with the Ministry of Finance and the National Bank of Moldova, has undertaken measures to prepare a subscription to the Special Standard of Data Dissemination (SSDD) of the IMF. With EU technical assistance, the economic statistics and Economic Accounts in Agriculture were reviewed in order to be approximated to the EU requirements. Conversion of trade statistics to EU standards has yet to be accomplished.

Conclusions

Moldova should strive to adopt European practices in the field of statistics as soon as possible in order to increase compatibility of collected data.

Chapter 4. Prospects for future relations between the EU and Moldova

4.1. Prospects for EU Membership

With the enlargement of the European Union as of January 1, 2007, Moldova will become the EU's direct neighbour. It currently has a developing relationship with the EU, but both the political elites and the population wish the final result to be EU membership. The EU, however, has resisted the call to provide the country with a membership perspective and firmly treats the country as part of its European Neighbourhood Policy[43].

The absence of a membership perspective for Moldova and other countries that have signalled their desire to accede to the EU contradicts the EU's tendency since 1993 to show commitment to their eventual accession. The prospective of membership is widely regarded as the EU's most powerful means of promoting and sustaining stability and reform, both political and economic in non-EU European countries.

In fact, the president of the EU Commission, Mr. Jose Manuel Barroso, has called for a pause in EU enlargement following the accession of Bulgaria and Romania. Mr Barroso stressed that there were limits to the EU's capacity to absorb new members without new rules to make an expanded bloc work effectively[44]. Further, he stated that it would not be wise to proceed with any enlargements before the problems with the constitutional issues in Europe are resolved and the current EU treaty provides for a maximum of 27 members before institutional changes are needed.

It must be acknowledged that the EU enlargement process needs to be broadly shared and supported by the peoples of Europe in order to ensure full democratic legitimacy. For enlargement to be a success, the EU must ensure the support of its citizens. The EU Member States also need to take the lead in effectively

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[43] Dr. David Phinnermore, Moldova: a step too far for EU enlargement?, ECPR-3rd Pan-European Conference on EU Politics, Bilgi University, Istanbul, Turkey, 21- 23 September 2006

[44] BBC News, EU Chief urges en largement pause, http://newsvote.bbc.co.uk

communicating information about the enlargement process and, in particular, the benefits that it offers EU citizens. In this regard, the European Council held debates on the enlargement at its meeting in December 2006.

Today, the EU enlargement policy is based on three basic principles: consolidation of commitments, conditionality and communication. Consolidation of the EU enlargement agenda means that the Union is cautious about assuming any new commitments, but honours its existing commitments towards countries already in the enlargement process (EC, 2006b).

The EU's capacity to integrate new members is determined by two factors:

- Maintaining the momentum to reinforce and deepen European integration by ensuring the EU's capacity to function;
- Ensuring that candidate countries are ready to take on the obligations of membership when they join by fulfilling the rigorous conditions.

As stated in the EC Communication on the Enlargement Strategy and Main Challenges released on November 8 2006[45], the EU's integration capacity will be reviewed at all key stages of the accession process. At the same time, the EU must ensure that it can maintain and deepen its own development while pursuing its enlargement agenda. Institutional reform is needed to improve the effectiveness of the decision- making of an enlarged EU and a new institutional settlement should be reached by the time the next new member will be ready to join the Union.

Although, a number of positive aspects of the ENP have been mentioned, the question remains whether this is more than a token policy to try to placate the new outsiders, and whether the balance of incentives versus obligations is sufficient to help Moldova make greater progress in implementing reforms. Unfortunately the Commission, undoubtedly supported by the majority of member states, declined to offer a perspective of EU membership for Moldova. Although some EU officials sharply deny rumours that Moldova may anticipate prospective EU membership, others have made comments to the effect that enlargement is not complete. This has given Moldova and other transition countries in the region hope for eventual EU accession.

As noted by EU analysts, the failure of the strategy paper to address the issue of EU membership may have unintended effects. For example, it may encourage Russia to puruse the re-integration of the CIS area or reignite Moldova's interest in re-unifying with Romania, in order to gain entry into the EU. However, many people consider this scenario highly unlikely given the existing conditions in Moldova and the

[45] Communication from the Commission to the European Parliament and the Council on Enlargement Strategy and Main Challenges 2006-2007, Including annexed special report on the EU' s capacity to integrate new members, Brussels, 8 November 2006.

recent declarations of Moldova's top officials. The Commission continues to prefer the bilateral "action plan" approach and it almost completely ignored the case for strengthening multilateral Pan-European organisations, such as increasing the role of the Council of Europe through specialised initiatives.

The Moldovan government has signalled a wish to see the country closely involved with the EU and it has led to the adoption of various declarations and strategy papers, as well as the establishment of a number of institutions aimed to improve Moldova's relations with the EU. Thus, relations have been improved both at the bilateral level and within the ENP framework, yet Moldova remains one of the few European countries wishing to join the EU that has not been offered a membership perspective. Further European integration has been the number one priority of both domestic and foreign policies. On March 31, 2005, the Moldovan Parliament unanimously adopted one of the first documents of the new legislature named the Declaration on the Political Partnership to Achieve the Objective of European Integration of the Republic of Moldova. By signing this declaration, the parliament committed itself to responsible cooperation between the government and opposition, stability of domestic politics and strengthening of Moldova's independence. The political leadership and civil society have voiced their irreversible stance in favour of European integration. Moldovan authorities chose not to passively wait for future developments, but have adopted an active and pragmatic stance to make use of every opportunity for integration. Political, legislative and socio-economic reforms conducted today are, in essence, European and are based on applying and adapting national systems of European legislative quanta and socio-economic models to local realities[46].

Moldova is using the possibilities offered by the Stability Pact for South Eastern Europe to promote its European integration policies. Moldova does not request special treatment but requests the same treatment applied to other countries of South Eastern Europe. By becoming a full member of the Stability Pact for South Eastern Europe and initiating association negotiations with the EU, Moldova will have the chance to cooperate with other European states and to take decisive steps towards European integration. Obviously, the most important issues that the Republic of Moldova must discuss and agree upon in the near future with the European Union are:

- The new contractual arrangement between the Republic of Moldova and the European Union after the efficient implementation of the EU-Moldova Action Plan and of the Partnership and Cooperation Agreement;
- Granting Moldova Autonomous Trade Preferences, (as a medium term objective); and further liberalisation of trade by signing of the Free Trade Agreement between the Republic of Moldova and the European Union;

[46] Speaker Marian Lupu's Address to the SEECP Conference, Athens, Hellenic Republic, March 17, 2006 http://www.parlament.md/news/17.03.2006/en.html

- Greater involvement of the EU in conflict resolution in Transnistria;
- Visa facilitation for Moldovan citizens travelling to Europe;
- The type of assistance that the Republic of Moldova will receive within the new European Neighbourhood and Partnership Instrument, etc.

Therefore, in the medium term, Moldova must seek the possibility of signing new bilateral Agreement with the European Union and gain EU candidate country status in the long-term. The perspective of Moldova to join the EU, however distant, would constitute a strong incentive to undertake efforts for further implementation of democratic and economic reforms.

In order to strengthen the EU's capacity to promote the ENP objectives in Moldova, one of the main priorities for the EU should be to gain leverage with its Eastern neighbours, as well as to supplement the long-term focus of ENP with visible and attractive rewards. To achieve that, a number of incentives for reform should be considered. In order to make EU conditionality work, the EU must increase the incentives to its new neigbors by offering them increased market access, and a clear road map towards visa-free travel for countries that comply with EU requirements. For Moldova, a strong incentive has been the EU's increased and direct participation in the conflict settlement in Transnistria as an observer.

Likewise, Moldova should concentrate on reforms in order to become a modern European state. It is a good opportunity to become more involved in European policies and to demonstrate the will and determination to overcome the extended transition period. Moreover many of the new EU member states (the Baltic States, Poland etc.) have shown a real interest in sharing their experience with Moldova. The process of transposition of the 'aquis communautaire' into Moldovan legislation should continue with even larger steps. But it is most important that Moldova not only transposes the EU legislation, but creates conditions for its implementation and effective enforcement. In order to increase its credibility, the timely and effective implementation of the ENPAP and EGPRSP by the Moldovan government is necessary and it should avoid frequently changing the policy targets, as this would make their achievement very difficult.

4.2. New arrangement between Moldova and European Union

On the eve of Moldova becoming the EU's direct neighbour, the basic framework exists for the development of relations. However, it is far from clear where that framework will lead and what any upgrade of relations will entail exactly. According to the ideas behind the ENP, the EU is committed to differentiating between its neighbours and tailoring relations to their specific needs and capacities as well as common interests[47]. It has also indicated that future relations may involve the conclusion of the new European Neighbourhood Agreements whose scope would be defined in light of progress in implementing Action Plans and set out the longer-term goals of relations[48]. Moldova is keen on such an agreement, seeing in it a replacement to the PCA (which either party may abrogate in 2008) and an opportunity to gain both an agreement on a free trade area with the EU and, more importantly, an Association Agreement. A key attraction of association in the Copenhagen commitment of the EU is that the "associated countries of the Central and Eastern Europe that so desire shall become members"[49].

Thus, the EU plans for the European Neighbourhood Agreements are at present unclear and in the absence of any membership perspective, however weak, the future of Moldova's relations with the EU continues to lack of clear sense of the final result. Moldova is looking forward forcloser integration than it currently enjoys and future EU membership but the EU remains cautious about what it is willing to offer the country.

4.3. Further trade liberalisation

4.3.1. Short term prospects: accession of Romania and Bulgaria to the EU (2007)

One of the basic rules of the EU is that member countries are not allowed to have bilateral preferential trading arrangements with non-member countries. For that reason the Romanian-Moldovan and Bulgaria-Moldovan Agreements[50] will have to be cancelled when Romania and Bulgaria join the EU on January 1, 2007.

In principle, bilateral trade with Romania has been free since 1995 with no quantitative restrictions or exceptions for sensitive products. Romania, which was once the second largest receiver of Moldavan exports absorbed 11% of total exports in 2005. However, with the approaching of Romanian accession, technical barriers have grown as Romania increasingly harmonised technical standards to those of the

[47] European Commission, 2004, European Neighbourhood Policy, p.8.
[48] Ibid., pp 3 and 5.
[49] Council of Ministers, European Council in Copenhagen, 21 -22 June 1993: Conclussions of the Presidency, Document SN/180/1/93 REV 1, Brussels, 22 June 1993, point 7.A.iii.
[50] The Free Trade Agreement between Romania and the Republic of Moldova was signed in Bucharest in 1994 and ratified on 22.09.1994. The FTA became effective on January 1, 1995, and has covered all agricultural and industrial products, all of which are traded duty free (excepting white sugar, on which Romania applies a protective measure in the form of tariff quota in amount of 14 thousands tones).

EU. Reconfirmation was increasingly demanded of Moldova conformity assessments although the FTA provides for a mutual recognition clause. Also, increasingly stringent sanitary and phytosanitary rules have limited the free export of Moldova's agro-food products to Romania.

Bilateral trade with Bulgaria has has grown steadily in the past few years and constituted 1.2% of total foreign trade[51]. In 2005, exports from the Republic of Moldova to Bulgaria were USD 7.6 million and imports were USD 29 million.

Box. 9. Trade between Moldova and Romania

In 2005, total foreign trade of the Republic of Moldova constituted USD 3.4 billion. Exports accounted for USD 1,091.3 million, increasing by 10.8% from the previous year. Imports were USD 2,311.8 million, increasing by 30,7% as compared with the previous year. Trade flows with Romania reached USD 369 million in 2005, of which USD 111.7 million was a result of expors and USD 257.4 million from imports. Exports to Romania account for merely 11% of Moldova's total export volume.

In 2006, Romania's trade with the Republic of Moldova has reached a record-breaking level, with a trade turnover of USD 411.2 million.

Moldavian exports to Romania are a mix of several products, with agriculture and food accounting for 39% of the total and industrial products for the remaining 61%. The primary export products are vegetable products (15%), textiles (11%), processed food products (11%), oils and fats (10%), glass and building material (9%), and mineral products (9%).On the contrary, Moldavian imports are more concentrated on mineral products (energy), which account for almost one-third of total bilateral trade. Processed food constitutes 12% and plastic products an additional 10%. Other significant imports are paper products (7%), glass and building materials (7%) and chemicals and fertilizers (6%).

The accession of Romania and Bulgaria to the EU means that Moldova will lose duty-free access to the markets of its immediate neighbours. At the time of accession, Moldova will begin applying the same tariffs it applies to imports for the EU to imports from Romania and Bulgaria.

Thus, beginning in January 2007, approximately 65% of imports from Romania will be taxed at the Moldovan border. According to preliminary estimates of the Ministry of Economy and Trade, this will reduce the influx of goods from Romania by some 30%. As Moldova is subject to the GSP+ system, on the day of Romanian accession to the EU, only about 75% of exported goods will enjoy duty free access to the Romanian market. Specifically, from a total of 873 product categories that characterize Moldovan exports to Romania, 115 of them will not be covered by the GSP+ scheme, 46 will be taxed, the other 69 products will be tax free. The current

[51] Free Trade Agreement with Bulgaria provides exemption from customs duties for industrial products and lists of agricultural products provided in agreement, for which there are set tariff quotas and exemption from customs duties on import.

value of these 46 categories represents USD 18.25 million. Taking into account the level of EU customs tariffs applicable to these products, the losses will amount to approximately USD 6.6 million.

Due to the fact that the GSP+ does not cover agricultural products such as sugars, meat, and alcoholic beverages, Moldova will loose the Romanian market for these products. Moreover, because Romanian producers will get access to structural funds, enjoying preferential credits and support, they will become more competitive than Moldovan producers of similar goods. Therefore, to maintain comparative advantages on the Romanian market, it would be beneficial to have an Asymmetrically Free Trade Agreement, or at least an Autonomous Trade Preferential Agreement with the EU.

Concerning the consequences of Bulgarian accession to the EU and the subsequent effects on tariff coverage, the "GSP+" is more far-reaching due to commercial preferences offered by Bulgaria. Thus, its accession will not affect the bilateral commercial exchanges with the Republic of Moldova, with some exceptions, primarily agricultural products, which are not included in the "GSP+".

4.3.2. Medium term prospects: Autonomous Trade Preferences

In the medium term, the EU is considering the option to grant Moldova Autonomous Trade Preferences, under which Moldovan exports would be given unilaterally free access to the EU Internal Market, with some reservations on the most sensitive products. In principle, this is one of the "priorities for action" identified in the EU-Moldova Action Plan.

The assessment of the potential benefits of the ATP on EU-Moldova trade relations is optimistic. It should be mentioned that the trade preferences, including autonomous trade preferential arrangements, are seen by many economists as a feasible alternative to financial and technical assistance, as reflected in the slogan "trade rather than aid". The idea that countries in transition, such as Moldova, should be given better opportunities for improving their economic situation through their own activities, with the hope of a lasting positive effect, rather than being dependent on aid provided by developed countries, is a highly favourable idea.

In general, the expected benefits from trade preferences are economic advantages, such as better access to developed countries markets, increased export volumes and prices, improved economic welfare, more jobs, and more rapid economic growth. In addition to the direct effects on production, investment and employment, exports may also provide "soft benefits" to exporting countries. Exports to the European Union and other developed markets require upgrading product quality, health and safety standards, which is likely to spread to all products of a supplier, including those designated for domestic consumption.

But, as is often the case, trade preferences have not only benefits, but also costs. While most of the benefits take the form of direct economic advantages, the costs tend to be hidden, and are often revealed only in the long term. Preferences result in costs for technical implementation and granting of preferences implies a **strong system controlling rules of origin**, which are quite complex. In the beneficiary countries, numerous administrative activities must be carried out in order to comply with the rules of origin and to satisfy the requirements of the preference-giving countries. Analysis of the experience of the Balkan countries suggests that rules of origin have been the most significant barriers to trade between those countries and the EU.

The EU conditions for granting the ATP to Moldova are also related to the proof of origin. (Box 10)

Box. 9. The EU-Moldova Action Plan stipulates that the Republic of Moldova must:

- Ensure effective control of the origin of goods in order to fully benefit from the Generalized System of Preferences;
- Improve the institutional framework and procedures on the control of origin by reinforcing customs and reviewing the division of responsibilities for the issuing and verification of both preferential and non-preferential certificates of origin with the Chamber of Commerce in order to build a solid basis for possible Autonomous Trade Preferences;
- Strengthen the overall administrative capacity, in particular, to ensure effective control of the origin of goods and the correct implementation of customs valuation rules, and provide the customs administration with sufficient internal or external laboratory expertise, as well as sufficient operational capacity in the IT area.

In order to meet these requirements of the European Commission, the Moldovan government has adopted an Action Plan to improve the regulatory and institutional framework on certification of origin of goods. According to Government Decision No.909 made in August 2005, the right to issue the certificates of preferential origin were transferred from the Chamber of Commerce and Industry to the Customs Service. Thus, the Customs Service is the only competent authority responsible for the certification of origin of goods for export to the EU Member States. The new scheme of issuance of certificates of preferential origin of goods took effect on July 1, 2006. Also, in order to ensure the transparency of the new normative acts, the Moldovan authorities notified the EU Member States about the new amendments, and provided samples of the signatures of designated customs officials and of the stamps of customs bureaus that are authorized to issue certificates of preferential origin of goods.

One issue holding up negotiations on ATPs is the EU concern that Moldova does not control its entire territory. This gives rise to two major problems. First, there is the lack of control of imports from Ukraine that reach Moldova through Transnistria. Although the potential for fraud is minimal at present because Ukraine's system of EU preferences (GSP) is only slightly less generous than Moldova's (GSP+), it will grow if Moldova is granted ATPs. Secondly, Moldovan officials do not have access to Transnistrian factories, and therefore cannot verify production procedures. This means that Transnistrians can still run illegal re-export schemes. Controlling imports would require Moldovan customs officials at these border points or an unprecedented level of information exchange between Ukrainian and Moldovan customs officials.

Some steps to overcome this situation were made. Moldova and Ukraine signed agreements not to accept Transnistrian products that were not accompanied by export documents obtained by registering with the Moldovan government. Under the new regulations, Transnistrian companies that wish to export can register either permanently or temporarily in Chisinau. The process is swift and inexpensive. Permanent registration grants the company the status of a regular Moldovan economic agent, with access to EU trade preferences but also obligations to the state budget such the VAT and income tax. Temporary registration does not provide access to EU trade preferences, but neither does it require any payments to the state budget. Companies that register temporarily may still export to the EU under the Most Favoured Nation (MFN) tariff rate, which for many products is not significantly less than the "GSP+" rate applied to Moldovan entities.

In light of the above, it should be mentioned that during the last meeting of the Trade and Investment Subcommittee, EU officials positively acknowledged the results of a Fact Finding Mission that visited Moldova this autumn. Hence, it is important to pay special attention to the enforcement of the new system and to ensure continuous control of economic agents. Meanwhile, the relevant EU authorities will start the preparatory work to define the text of the Regulation on granting Autonomous Trade Preferences to the Republic of Moldova. The list of goods, both negative and positive, and eventual quotas will be developed. Essentially, it is expected that the in next 7-8 months Moldova could enjoy a new system of trade preferences.

4.3.3. Long term prospects: EU-Moldova Free Trade Agreement

If the European Union and Moldova decide to extend the format of trade relations by signing a free trade agreement, the scenario would most likely follow the framework used by the EU in the case of the Balkan countries where trade provisions have been put into a contractual agreement known as the Stabilisation and Association Agreement.

Regarding the negotiation of a Free Trade Agreement between Moldova and the EU, it is worth mentioning that this move is deemed as much more important Moldova as compared to access to EU Autonomous Trade Preferences, which implies creation of a bilateral legal framework with explicit commitments undertaken by both counterparts. Furthermore, in order to negotiate such an agreement it is necessary to create political pre-requisites and to make considerable efforts to make it happen.

Free trade agreements can play an important role in helping to lock-in domestic reforms. However, a free trade agreement will have little or no impact if the domestic reform process itself is not coherent and credible. A key issue is the costs of 'punishment', and the mechanism by which it is administered, if partners deviate from the agreed liberalisation strategy. These costs must be sufficiently large in order to convince both domestic and foreign firms that existing reforms will not be unravelled and the reform process will be fully implemented.

The other issue is the inclusion or exclusion of agricultural trade liberalisation. Excluding it from the free trade agreement would significantly undermine the economic benefits for Moldova. If Moldova desires to become integrated into a wider system of European production, which at the moment is typical of the performance of many sectors, then it is necessary to take effective measures for harmonizing its policies with the EU and to ensure reciprocal recognition of the respective regulations. This work requires considerable effort to ensure institution building and effective implementation of such regulations in Moldova.

The European Agreement of Association or a Free Trade Agreement will most likely serve to enlarge the spectrum of commitments assumed by Moldova in diverse domains, such as competition policy, assistance granted by the state, public procurements, customs procedures and observance of technical standards. Adoption and effective implementation of the new practices and laws compatible with those of the EU will require significant enlargement of the capacity and efficiency of the legislative and judicial system of Moldova. Intensifying domestic reforms and creating pre-requisites for signing a European Agreement of Association or Free Trade Agreement will serve to considerably enlarge the credibility of relations with the EU and will contribute to enhancing efficiency, while sending an important signal to investors and merchants.

4.4. Greater involvement of the EU in Transnistria

For the last two years the EU has been actively involved in the Transnistrian conflict resolution. Actions undertaken in this regard have proved to be useful and efficient. (see section 2.5) External observers note that the transformation is already under way as a result of EU monitoring of the Transnistrian border with Ukraine, and as a result of the new customs procedures that Ukraine and Moldova have begun to implement. Although the EUBAM and the customs procedures are having a direct effect on the Transnistrian regime, they have important limitations. Thus, the most desirable outcome for the medium term would be that the EUBAM mandate is extended beyond 2007. If so, it is easy to imagine that the Transnistrian elite will bend more towards Chisinau, being attracted by the 'European' opportunities and values such a decision would provide.

There are many issues important to the 'Transinistrian' agenda, which the EU can support including:

- Open and permanent dialogue with the Russian Federation and Ukraine. In the case of the Russian Federation, the key priority of discussions should be directed to the withdrawal of Russian troops and weapons from Transnistria and fulfilment of the Istanbul commitments. In the case of Ukraine, the crucial question should be focused on continued monitoring of the Ukraine-Moldova border.
- The EU can also assist Moldova in becoming more attractive to its citizens. Increased economic reform, a better business climate, and a deeper and faster democratisation of Moldova are central in this regard.
- More openness from the EU in allowing for the circulation of Moldovan citizens, particularly students, businessmen and civil society activists, would be important, as well as greater openness of markets. This is due to the fact that any European prospective for Moldova is likely to have effects on Transnistria as well[52].
- EU funds and programmes should be available to Transnistrian NGOs and the EU should increase its visibility in the region.

Of course, EU support in making Moldova attractive will not be effective without a clear commitment to democracy, decentralisation and economic reform by Moldova.

Both the EU and Moldova can make efforts in order to involve Transnistria in the implementation of at least some of the provisions of the EU-Moldova Action Plan.

4.5. Meaning of the new European Neighbourhood and Partnership Instrument for Moldova

The European Neighbourhood and Partnership Instrument that will be active as of January 1, 2007 is designed to target sustainable development and greater alignment to EU policies and standards, supporting the agreed priorities in the ENP Action Plans. Under the ENPI, assistance will be provided namely to country ormulti-country programmes, thematic programmes and cross border iniatives. Legislative

[52] Nicu Popescu, EU in Transnistria: From Deadlock to Sustainable Settlement, http://www.azi.md/print/37219/En

approximation, regulatory convergence and institution-building will be supported through mechanisms which proved successful in transition countries that are now EU Member States. This includes targeted expert assistance (Technical Assistance and Information Exchange – (TAIEX), long-term twinning arrangements with EU Member States' administrations – national, regional or local – and participation in Community programmes and agencies.

Under both current and future instruments, EC assistance priorities will be identified, together with the country and other relevant actors, in the general Country Strategy Papers (CSPs), which cover seven year periods, as well as, more detailed Multi-annual Indicative Programmes (MIPs) which cover three years, and detailed annual programs. The priorities identified in the Action Plans, agreed upon by the authorities of Moldova, are also useful in guiding the implementation of assistance programs, – including those funded by other donors and international financial institutions (IFIs)[53].

On the basis of the current neighbourhood instruments, Moldova should clearly take advantage by modernizing and upgrading its economy and institutions in line with existing EU standards. When this is achieved, European accession will be a matter of formal agreements. Massive education campaigns should be conducted aside from reforms. Increased European investment into the professional training of present and future administrations of Moldova, through education programs, academic mobility programs and public awareness initiatives, is greatly needed. Romania and the "new European countries" could also provide valuable assistance by sharing European integration experiences.

Within the ENP framework, Moldova will receive assistance under the new Neighbourhood programmes. As a future neighbour of the enlarged Union, Moldova will benefit from the Commissions' efforts to promote further cross border and regional cooperation. It can be stated with a large degree of certainty that the EU will give great importance to Moldova's cross-border co-operation with Romania, though only 5% of the funds allocated through the ENPI are declared to be devoted to cross-border cooperation programmes. Nevertheless, given the declaration of Romania's accession to the EU, this could have many other potentially beneficial, non-monetary implications for Moldova.

Further, Moldova became eligible for assistance within the Twinning Tools. Twinning projects are a new type of pre-accession assistance for institutions that was launched in May 1998. Given that they are already implemented in Romania, Bulgaria, Poland and other recent and prospective members of the EU, their extension to Moldova should not pose any major problems since it will not require many financial commitments and it is more of a political decision. The first steps in this respect have been made already. The Twinning Projects aim at assisting the

[53] http://ec.europa.eu/world/enp/funding_en.htm

Public Authorities to transpose the Acquis communautaire, or parts of it, in the case of Moldova of course, that will be chosen by the Moldovan government, in bilateral acts with the European Union. The twinning programme should facilitate structural reforms, by solving systematic problems.

At the same time, many EU countries are not fully satisfied with the way EU money is being distributed through the Pan-European programmes and these countries prefer to distribute their assistance through bilateral channels. This could be attractive for Moldova, since as a whole, the amount of resources allocated for the ENP will increase. However given the larger number of beneficiaries, in real terms, Moldova may receive lesser funds.

The Republic of Moldova needs help and assistance and the European Commission should intensify its efforts in helping the country make headway towards European integration. Moldova needs well-trained people both in public administration and in other fields, who will implement efficiently the provisions of the EU-Moldova Action Plan and those of the PCA.

4.6. Visa facilitation for Moldovan citizens travelling to Europe

The EU-Moldova Action Plan provides that the EU will pursue a dialogue with the Republic of Moldova concerning cooperation on visa policy, exchange of views on Schengen procedures and initiate a dialogue on the possibilities of visa facilitation in compliance with the *acquis* dialogue. It also calls for dialogue concerning visa co-operation, notably the criteria and procedures for issuing visas, and dialogue on document security.

Moldova requested that the EU open talks on the visa facilitation regime, not only because of Romania's accession to the EU, but also because Ukraine is in the process of negotiating such a facilitated visa regime with the EU. The Council of Ministers of the European Union adopted the mandates authorising the Commission to negotiate agreements for less restrictive short-stay visas and readmission between the European Community and the Republic of Moldova. The negotiation process of these two agreements is expected to start early next year, with the aim of ensuring a simultaneous entry into force of the agreements before January 1, 2008. The visa facilitation agreement will not lift the visa requirements for Moldovan citizens (except for holders of diplomatic passports). For certain categories of persons, like businessmen, students or researchers, the necessary documentary evidence will be simplified, making it possible for them to obtain multi-entry visas with long period of validity and exempt them from handling fees. The readmission agreement will set out clear obligations and procedures for the authorities of both the Republic of Moldova and the EU Member States as to when and how to take back people who are illegally residing in their territories.

On the top of negotiating with the whole Union, since 2005, the Republic of Moldova intensified its bilateral negotiations with the EU Member States on facilitation of the visa regime. That resulted in the signing bilateral agreements with Lithuania and Poland. At the same time, following the negotiations between the two countries, starting on January 1, 2007, the citizens of Moldova will receive fee-free visas to visit Estonia, with Moldovan diplomats able to visit this country without visas.

The EU Member States have accepted the suggestion of the European Commission, to launch Moldova in the pilot project in regard to the joint centres for issuing visas. Presently, Hungary has confirmed the decision to undertake the role of "leading country" in creating such centre in Chisinau. Austria and Slovakia have taken up the EC proposal. The other member states are invited to join the initiative. The centre should be established during 2007.

Moldova's concerns regarding visa fees and the implications for the EU membership of Romania is obvious. Romania's accession to the EU will have a negative impact on Moldovans' freedom of movement, as Romania is currently the only country in Europe to the west of Moldova where Moldovan citizens can travel freely without a visa. Previously as a result of a full open border policy, Moldovan citizens were required to show only a valid passport for crossing into Romania. However, as of January 2007, they have to obtain a visa in order to travel to Romania. The agreement between Moldovan and Romanian governments on a mutual travel regime was signed in Bucharest on October 20, 2006. The agreement stipulates visas free of charge, including the possibility for issuance of multiple-entry visas. The Romanian party's intention is to grant a set of facilities, while observing the EU acquis provisions, whereby it can meet the specifics of the political relations developed by the two countries. The Romanian Consulate in Chisinau began accepting visa applications from Moldovan citizens in November 2006. Moldovans citizens' holders of Schengen visas or residence permits from any of the EU Member States will not need transit visas for Romania.

Once Romania introduces a visa regime for Moldovan nationals it will become more difficult for Moldovans to obtain a Schengen visa. This is due to the fact that there are only two EU Embassies in Chisinau that are issuing Schengen visas, namely the German and French Embassies. However, if Moldovan citizens need to obtain a Schengen visa for entry into another Schengen state, for instance Belgium, they need to travel at least twice, once to apply and again to retreive their visa, either to Bucharest, or Kyiv. Thus, as of 2007, Moldovan citizens will first have to apply for a Romanian visa in order to travel to Bucharest, to obtain a Schengen visa, with the exception of Schengen visas to France or Germany. In other words, Romania's accession to the EU will become a serious impediment to the freedom of movement of Moldovan citizens, although Moldovan citizens will still have the possibility to travel to Ukraine to retrieve their Schengen visa. It seems ridiculous to have to travel to a neighbouring country several times in order to obtain a visa for a third (EU) country[54]. The already mentioned joint centres for issuing visas can be a solution.

On June 8, 2006 the Moldovan Parliament adopted a law on the unilateral waiver of the visa regime for citizens of the EU Member States, USA, Canada, Swiss Confederation and Japan. According to Article 1 of the law, the visa regime is abolished in relation to citizens of the above mentioned countries beginning in January 2007. Abolishment of the visas for EU citizens and the asymmetric visa regime with the EU will have a positive impact on Moldova, contributing to the increase of revenues from tourism, trade and investment from the EU.

On its behalf, the EU can persuade more of its Member States to open consulates in Chisinau or to join the initiative of common visas centres, and to be less restrictive towards Romania, especially after Romania becomes a Schengen state, with regard to the degree of flexibility of the visa regime that will exist between Romania and Moldova.

[54] George Dura, A tale of two visa regimes- Repercussions of Romania's accession to the EU on the freedom of movement of Moldovan citizens, Eurojournal.org, January 2006.

Chapter 5.
Opinions of Moldovan economic actors on EU integration

This chapter presents attitudes of Moldovan economic actors such as entrepreneurs, journalists, and public administration representatives regarding the market economy, integration with the EU and relations with the CIS. To qualify, respondents were required to be vitally interested in economic ties with the EU because of their everyday work (entrepreneurs, public administration, academics) and/or have significant influence on the public opinion in this sphere (media, teachers). The aim of the survey was to understand the state of knowledge and attitudes towards the economic principles of the EU in Moldova.

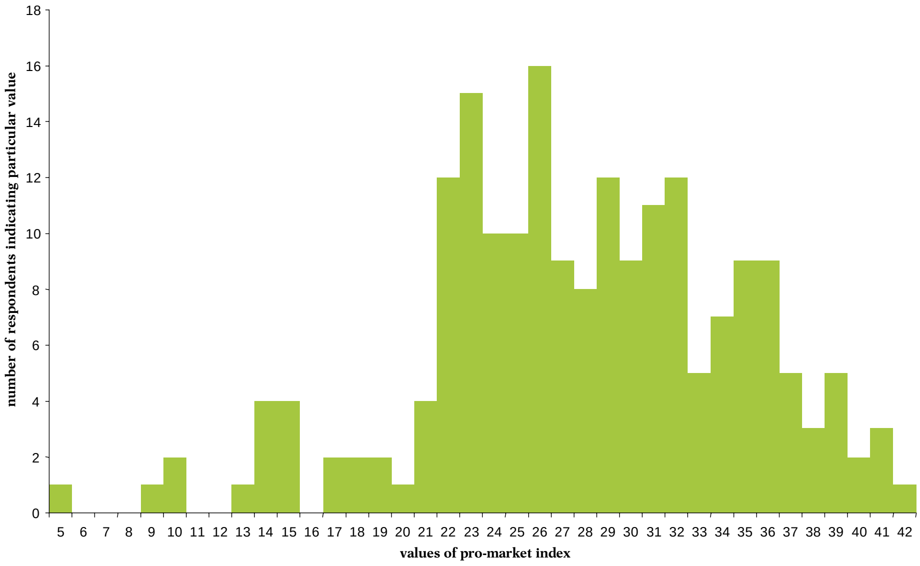
The survey was conducted among 201 respondents. Most, 78%, worked in private enterprises. The remaining 22% represented public administration, education and media sector employees. All respondents were between the ages of 20 and 58 with 44% women and 56% men

5.1. Pro-market attitudes

In order to measure the general opinion of the market economy, the respondents were asked five questions in which they were to choose between statements that described pro-market and market-sceptical attitudes. The statements concerned respondents' attitudes towards inequality of incomes, private ownership, relations between personal and public responsibility, competition, and economic freedom.

The most widely supported value connected with the market economy is competition. Nearly 65% of those interviewed were convinced that market competition is generally beneficial for society. Nearly the same high support was found for the principle of private ownership and for the reduction of state control over companies. The differences in incomes, as well as the responsibility for social insurance, resulted

Figure 11. Distribution of the pro-market index, survey results



Source: Survey results, own calculations.

in more diverse reactions. More than a half of our respondents assessed social security as the sphere of the responsibility of the state.

In general, the results show that 'Moldovan economic players'[55] demonstrate positive attitudes towards the market economy, which may be regarded as a pro-EU value. This is not surprising since most respondents represented private businesses. The graph below shows the distribution of a 'market support index' created on the basis of the reaction to the above-mentioned statements. Values of the index are on the horizontal axis, while the number of people giving a particular answer is on the vertical axis. Theoretically, the index could range from 5 to 60, but the actual range in our population was from 5 to 42. The distribution is skewed away from low values (few respondents being sceptical about fundamentals of market economy), which can be interpreted as a prevalence of pro-market attitudes.

5.2. EU image

The next set of questions concerned the image of the EU. By and large, the European Union has a very good image in the opinions of respondents. This was

[55] This term is used throughout the charter to describe the respondents.

studied using a series of eight statements on various aspects of the EU functioning. Most of those interviewed tended to agree with the positive characteristics of the EU and express a neutral position or disagreement with the statements expressing negative opinions about the EU.

A great majority of respondents agreed that in the EU there is 'good organization of work' (85%), 'freedom of speech is respected' (83%) and there is an 'effective financial support for member-states' (82%). Fewer respondents, but still a majority, supported the opinion that the EU has 'fast economic growth' (55%).

Negative statements describing the EU as a place where 'foreigners are not welcome' (37%), 'there is high unemployment rate' (34%) and 'too much bureaucracy' (30%) were indicated much less frequently.

5.3. Future accession

A large numberof the respondents supported the idea of Moldova's accession to the European Union. Only 7% were against it. One of nine could not yet decide regarding the accession question, however, the majority of respondents said that the best relationship between the EU and Moldova would be strong cooperation – both political and economic. The respondents who opposed Moldova's accession believed that the best way form of cooperation between Moldova and the EU would be through the framework of the Neighbourhood Policy (75% of opponents) or PCA (20% of opponents).

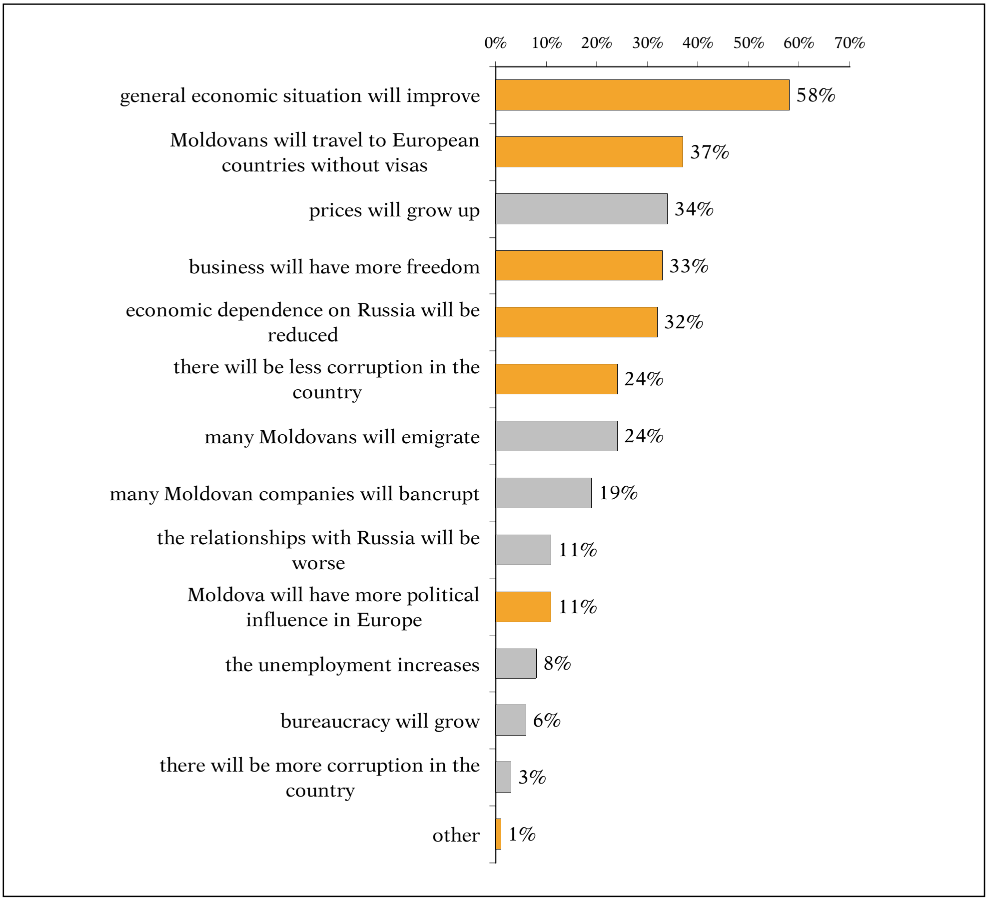
The most commonly repeated arguments in support of future accession concerned economic gains, namely that the perspective of accession will 'ensure stable economic development', 'bring new investments to the country', 'give free access to the European market' and so on. Among non-economic reasons for joining the EU in the future, respondents mentioned free movement of people, i.e. cancellation of visa regimes with most of European countries, guarantees for political freedom, more effective protection of human rights and obtaining more independence from Russia.

Some of those respondents who were against the accession also mentioned the Russian argument, claiming they like Russia and do not want to sever anyties by joining the EU.

Generally, the respondents frequently saw more positive than negative outcomes of the accession with 58% feeling that joining the EU would be beneficial for Moldova and more than one third (35%) did not mention a single negative outcome of the integration. However, there was also the pessimist group which comprised 16% of the surveyed population. This group (2%) indicated only negative outcomes and was convinced that the accession would not bring any benefits to Moldova. The list of possible outcomes of accession, with the percentages of respondents agreeing with a given opinion, is presented in the graph.

The first negative outcome appears on the third position according to the frequency of indications, with growth of prices mentioned by 35% of respondents. Other economic problems, such as bankruptcies of Moldovan companies and resulting unemployment, were indicated by lower percentages of the studied population and took positions closer to the end of a list.

Figure 12. Expected outcomes of the accession, survey results



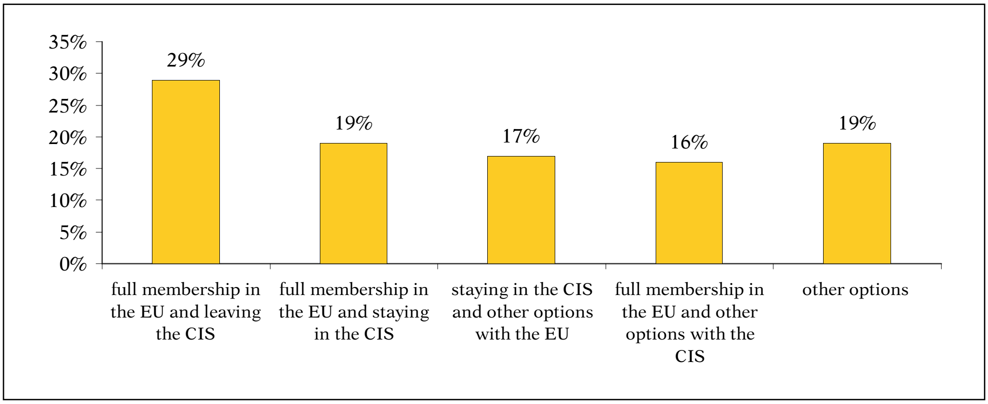
Note: orange bars denote positive outcome of the accession, grey - negative.
Source: Survey results, own calculations.

5.4. Future of Moldova in the CIS

An interesting issue was the future of Moldova's relationship with the Commonwealth of Independent States. On this subject, our respondents were not unified as there were as many opponents as supporters of the idea of Moldova leaving the CIS, with 18% not having an opinion on the issue.

The respondents who wanted Moldova to stay in the CIS indicated the importance of economic links with the former USSR countries, includinge established businesses and jobs in the CIS, as well as, the importance of good relations with Russia, as a major supplier of energy resources to Moldova. It is interesting, that many more arguments were given in support of the opposite attitude that Moldova should leave the CIS. These respondents mentioned the domination of Russia in this organization and the political character of the CIS as a Russian instrument of influence.

Figure 13. Future relations with EU and CIS, survey results



Note: in % of surveyed population supporting a given option.
Source: Survey results, own calculations.

It is worth mentioning that a majority of those supporting the continuation of CIS membership also wanted membership in the EU. On the other hand, the EU supporters mostly thought that Moldova should leave the CIS. Nevertheless, the group who believed that Moldova should both join the EU and stay in the CIS was quite significant. This group accounted for 19% of those surveyed, meaning that one in five respondents wanted Moldova to be a member of both integration structures despite that these are clearly mutually exclusive statements. Thus, this 19% of Molodvan economic actors can be classified as not fully understanding the principles of these two economic blocks.

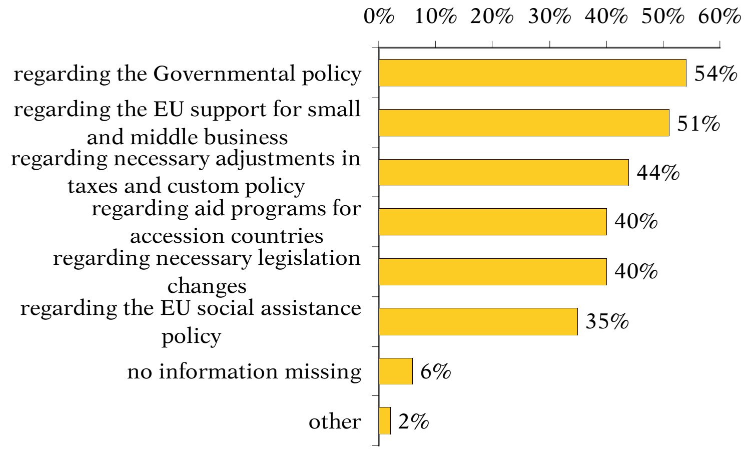
5.5. Information on EU integration

One of the main problems associated with European integration is the awareness of the process among society and its elite. In all the countries that joined the EU in 2004, this issue was widely discussed yet, no solution has been found.

Most of our respondents did not feel well informed. Only 26% claimed that their level of information was satisfactory, but even within this group there were people indicating important gaps in their knowledge about the accession/integration process.

Respondents find the information on the economic integration mostly in the Internet (68%), the Moldovan press (64%), television (60%) and Romanian television (52%). The Internet also had the highest number of indications (50%) as the most trusted source of information on the EU-Moldova issues, followed by Romanian TV (29%). Moldovan TV and press were trusted only by 21% and 13% of the respondents, respectively.

Figure 14. What kind of information on EU integration is missing, survey results



Note: in % of surveyed population supporting a given option.
Source: Survey results, own calculations.

5.6. Action Plan, speed of integration and challenges ahead

A significant gap in knowledge about the integration process is knowledge of the EU-Moldova Action Plan, which was known by only 36% of respondents. Some of those who considered themselves well informed about the accession were not familiar with the Action Plan. When asked more precisely about the content of the Action Plan, the respondents typically had only a general orientation.

Even if the level of knowledge about the content of the Action Plan is not overly high, the respondents were generally dissatisfied with the way the Plan is being implemented by the government, with 65% responding that they were 'rather dissatisfied' or 'definitely dissatisfied'. Thus, it seemd that this was the expression of a general distrust in the government's effectiveness on the issue of European integration. The limited capacity of the government was also mentioned by 63% of Moldovan economic actors as the third most important obstacle for European integration. Other obstacles mentioned were the conflict in Transnistria (78%) and corruption (72%).

The respondents indicated the following issues that need to be tackled before joining the EU: fighting corruption (58%), improvement of the investment climate (50%), support for small and middle enterprises (35%), improvement of transparency in decision making process (27%), improvement of social assistance effectiveness (22%), reduction of the external debt (22%) and reduction of economic and social impairment in the country (15%).

Taking all these issues into consideration, our respondents demonstrated quite optimistic attitudes and the majority of them were convinced that Moldova could join the EU in approximately 10 years. One in four was even more optimistic, expecting the accession in 4-5 years or even earlier.

The speed of the integration process depends first of all on the Moldovan government as 48% of respondents think that its activity can speed up the process. Also, 23% believe the integration can go faster with the political decisions of the European Union and 18% believe that close cooperation with Romania will be helpful in increasing the speed of integration.

Chapter 6.
Summary and recommendations

Moldova will become the direct neighbour of the EU in January 2007, as a result of the accession of Romania and Bulgaria. Becoming a 'closer' neighbour in the geographical sense will also have important economic and political effects, particularly with regard to evolving direct EU-Moldova relations. This report tries to shed light on how the future economic relations between the EU and Moldova may look, and what conditions are necessary to bring about the optimal scenario.

First, it is worth noting that EU-Moldova relations have become increasingly real and intense in recent years. Their future is still dominated by the perspective of EU membership. On the one side, Moldovans expect a membership perspective in a more or less fixed term, while the EU has resisted presenting a clear prospect on the issue, instead treating Moldova as part of its European Neighbourhood Policy. This situation does not seem likely to change soon.

Notwithstanding, closer links with the EU have been high on the agendas of successive Moldovan governments. This was demonstrated by the adoption of various declarations and strategies, as well as in the changing of Moldovan institutions, with the goal of bringing them more in line with EU standards. It seems that in the years to come, Moldovan authorities should take the initiative and intensify implementation of political, legislative and socio-economic reforms that will bring Moldova much closer to the EU. Future relations should not only be understood in formal terms, i.e. through trade liberalisation agreements, but also in the sense of shared European values and standards. Taking all this into account, the continuous implementation of the action plan should remain the priority of the relations between the two parties and it should continue to be monitored on a regular basis.

Future developments in mutual economic affairs will relate to the EU granting Moldova Autonomous Trade Preferences. This is expected to happen some time in 2007-2008, depending on the speed of negotiations. Under this system, Moldovan exporters will gain free access to the European Common Market limited by restrictions on sensitive (mostly agricultural) products. Moldova currently has been negotiating the access to 'sensitive' market segments, having in hand the argument of

Romania joining the EU in 2007, and the losses suffered by Moldovan exporters as a result of the EU common external tariff. The ATP is clearly a desirable short-term outcome. However, it has a disadvantage in the trade of agricultural products, especially since it relates to trade barriers on the export of Moldovan wine. Thus, Moldova should focus on the long term objective of establishing a free trade agreement with the EU, including provisions on the liberalisation of agricultural trade to the largest extent possible.

Of course, Moldova should not limit the range of its reforms in the near term only to the objectives of the action plan. It may go even further by beginning to implement the *acquis communautaire* in selected areas.

There are a number of measures that can support the development of the Moldovan economy in the near future and bring it closer to the EU. Based on the findings of this report, the authors propose giving the priorities to the following steps in the field of domestic economic policy:

- Moldovan reform in the ownership structure of the economy and its consequences. Recently, several important asset sales failed or were postponed, most notably the failure to even include Moldtelecom on the list of enterprises to be privatised in the near future. Pressure should be put on the government to restart the privatisation process as soon as possible and to put forth a stronger effort regarding full adherence to the new legislation. In this context, the law on the management and denationalization of public property should be adopted as well. This would be considered a success story if it is accompanied by the disposal of unnecessary state-owned assets and an improvement of public property management where it is required.
- Of course, an insufficient capital market is one of the factors restraining the process of privatisation and economy restructuring. Therefore, domestic financial intermediation should be boosted. There are plans to merge several existing public authorities into a State Commission for Financial Markets, under which responsibility for the securities market, insurance companies, private pension funds, investment fund and credit institutions other than banks will fall. It must be underlined that the outcome of such a solution will be positive only if the mega-regulator remains independent from political pressure.
- A crucial element in the failure of the privatisation programme to reach planned targets was the lack of interest of international investors. It seems that bureaucratic procedures are an additional aspect of excessive state involvement in the economy. The country depends to a large extent on foreign capital to complete the privatisation process and shoulder the burden of enterprise restructuring. The recently approved Investment Attraction and Export Promotion Strategy for 2006-2015 should be implemented. Ideally, attracting domestic and foreign investment

will force movement in demand-side induced growth, which is to a large extent based on remittances and their effect on domestic consumption, to a situation characterized by a sustained domestic supply-side response. However, it should be remembered that the most important task for Moldova, in order to attract productive foreign investment, is to create a favourable investment climate with as few obstacles to trade and invest as possible.

- In this regard, the government should now concentrate on the broader use of the elements of the 'one-stop shop' procedure, in order to facilitate the system of granting permits for all entrepreneurs. Also, further efforts can be directed towards improving the system of exchange of electronic data by the public administration.
- Entrepreneurs in Moldova report major barriers relating to regulation, tax administration and state interference, as well as inefficient judiciary and ineffective customs system. The procedures should be simplified and the number of permits should be limited. These measures should also support efforts to combat corruption.
- However, one should remember that there is a threat of growth of the bureaucracy within the process of implementation of EU standards. Moldova should learn from the integration experiences of the EU newcomers, in order to avoid overregulation that might occur as a result of the creation of new procedures and building new institutions. Bureaucratised and inefficient regulators would be a significant hindrance to growth.
- Improvement in the transparency and equitability of the fiscal system in order to broaden the tax base, will be important in the future, in particular this can be accomplished through a gradual elimination of tax exemptions, and strengthening of the tax collection and control systems.
- The public procurement system should be implemented at a different level of public authorities. The first step towards this goal is awareness of public authorities and the elimination of different system exemptions and loopholes for system evasion.
- Investment in education is required and is well justified. Moldova needs people with better training both in public administration and in other fields. This is especially important given the problems of the Moldova labour market, such as the vast labour force outflow and the overwhelming dominance of the Chisinau region in the creation of jobs.
- Another labour market related issue is improvement of the financial sustainability of the social system. The link between pension system contributions and its benefits is weak and it requires strengthening. Therefore, reform in the pension system and the implementation of the individual

accounting system of state social insurance contributions by the integration of data on contributions in the Social Fund database should be continued.

- Market surveillance is another important subject. Thus far, the Moldovan quality assessment system has only been recognised by CIS countries and Romania. Market surveillance is carried out by numerous state organizations and is a source of considerable burden to business development. The new legislation that includes clear differentiation between products from regulated and non-regulated markets is needed. Broadly speaking, there is a role for the authorities to improve the conceptual and legal framework in the sector.
- Moldovan authorities should also concentrate on further adoption of the EU technical standards. This would allow firms to be more internationally competitive.
- So far Moldova has made small efforts in the field of competition and consumer protection. The country should focus on institution building and a competition office should be established. Taking into account the size of Moldova, the pressure should be put on its capacity, since the office will have much work to do in the sphere of international cooperation. Further, taking into account the fate of competition policy in Russia and Ukraine, the emphasis should be placed on simple legislation and on the creation of a truly independent regulator. Otherwise, the chances for implementing efficient competition policy are small. Moreover, the state should encourage the establishment of consumer protection associations and support consumer and competition advocacy.
- Moldova clearly needs to modernize its economy and institutions in line with existing EU standards. This should be accompanied by education campaigns supporting the reforms. Also, professional training of the present and future administration of Moldova by enacting education programs, academic mobility programs and public awareness initiatives is greatly needed. Moldova should also use integration experience of the new EU member states, particularly that of Romania and the member states that entered the EU in 2004.

EU technical assistance should be directed in line with at least some of these actions, in order to facilitate the transition.

There is also a range of issues, in which closer or continued cooperation with the EU is needed. The problem of Transnistria is important, both in terms of Moldovan internal affairs, and in the reduction of the grey zone. Moldova pays a high price for not controlling its whole territory. Firstly, it does not yet control imports from Ukraine that reach Moldova through Transnistria. Secondly, Moldovan authorities do not have access to Transnistrian factories, and are therefore unable to control production procedures. This means that the Transnistrians can continue to illegally re-export goods. The Moldovan government should combat smuggling, people trafficking and weapons proliferation by extending its customs control and boosting customs capacity along the entire border with Ukraine. This should be accompanied by an information exchange between Moldovan and Ukrainian border controls. The EU clearly has much to gain by granting assistance to this project. Once Transnistria is able to realize the economic incentives that result from registered activities, it will cease to be a 'breakaway' region. However, it is crucial that the Moldovan authority is backed by the EU. Assistance in creating a policy concerning the granting of certificates of origin for registered and transparent enterprises is clearly a step in right direction. Additionally, the authorities should concentrate on establishing instruments which break the structure of interests sustaining the Transnistria status quo through economic reforms that improve the general business climate and strengthen democratic institutions.

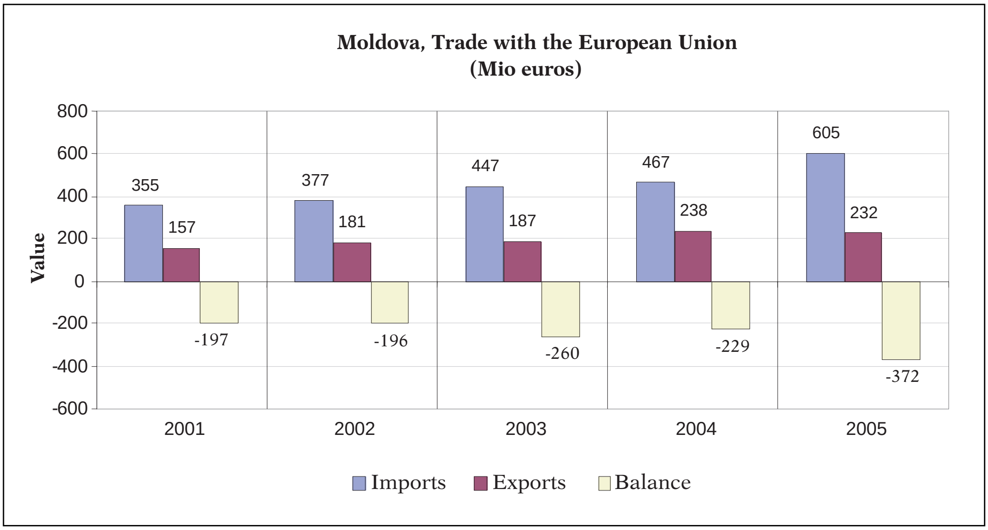
Another issue relates to lobbying in favour of easing visa requirements for Moldovan citizens[56]. Romania's accession to the EU will have a negative impact on Moldovans' freedom of movement. Romania is currently the only country in Europe to the west of Moldova to where Moldovan citizens can travel freely without a visa. This will no longer be the case as of January 1, 2007. As only two Schengen embassies are currently operating in Moldova, it is in Moldova's interest to encourage Schengen member states to establish consulates in Chisinau. If this is not possible, then intensive efforts should be continued in order to create a Schengen centre in Chisinau, which would issue visas on behalf of the Schengen countries not possessing a consulate in Moldova.

Concerning trade, the accession of Bulgaria and Romania will automatically void the bilateral trade agreements Moldova has with those countries. As a result, Moldova will lose duty-free access to its immediate neighbour's market, accounting at present for 11% of exports. This especially concerns agricultural products as those are not covered by the GSP+, meaning that Moldova will loose the Romanian market for these products. A strong commitment should be made in the area of abolishing of trade barriers[57].

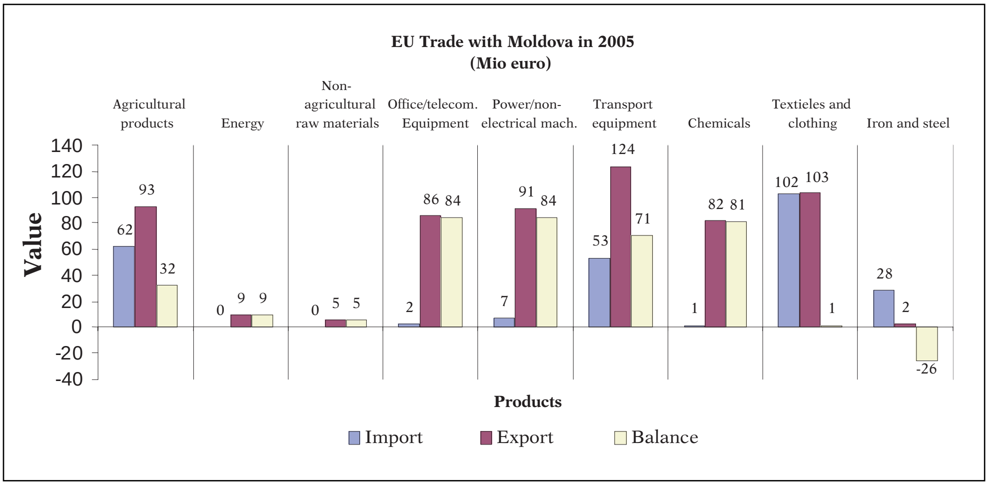
[56] Some of the Moldovan citizens have double citizenships (mainly Romanian), therefore they will obtain Schengen visa easier than the one who only have Moldovan citizenship. However, for those Moldavians who have not got Romanian visas, the barriers on their mobility will increase in 2007.

[57] See the point on trade liberalisation earlier in the recommendation part.

Annex 1.
EU-Moldova trade structure



Source: IMF (Dots) (excerpted from http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111540.xls)



Source: Eurostat (Comext, Statistical regime 4) (excerpted from http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_111540.xls)

Annex 2. Mandate of the EU Special Representative for Moldova

- Strengthen the EU contribution to the resolution of the Transnistria conflict in accordance with agreed EU Policy objectives and in close coordination with the OSCE;
- Assist in the preparation, as appropriate, of EU contributions to the implementation of an eventual conflict settlement;
- To enhance the effectiveness of border and customs control and border surveillance activities in Moldova and Ukraine, along their common border, with a particular focus on the Transnistrian section, notably through an EU Border Mission;
- Promote cooperation on border issues between the Moldovan and Ukrainian sides, also in view of building preconditions for a settlement to the Transnistrian conflict.

Source: Council Joint Action 2005/776/CFSP of 7 November 2005 amending the mandate of the European Union Special Representative for Moldova, Official Journal of the European Union, L 292/13.

Annex 3. Account of progress registered in 2005-2006 in the implementation of the EU- Moldova Action Plan provisions related to settlement of Transnistrian problem

During the period of the implementation of the EU-RM Action Plan the following progress was registered in this regard:

- Moldova continues to develop the political dialogue and co-operation with the EU structures and institutions regarding the settlement of the Transnistrian conflict.
- It maintains permanent contacts on various issues with the EU Special Representative for Moldova, representatives of the EU Troika, Heads of EU Missions accredited to Moldova, as well as with the members of the European Parliament Delegation responsible for the relations with the Republic of Moldova;
- Moldova supported the inclusion of the EU and the U.S. in the negotiation format 5+2 (September 2005). After a longer pause caused by the 2004 school-crisis, Moldova participated again in the talks 5+2 format. However, Moldova left the February 2006 negotiation round;
- On 10 June 2005, the Moldovan Parliament adopted a Declaration on the Transnistrian settlement Plan of Ukraine and two appeals to the international community regarding the criteria of democratisation, the principles and the conditions of demilitarisation of the Transnistrian region of the Republic of Moldova;
- The Law on the basic principles of the special legal status of the Transnistrian region was adopted on July 22, 2005;
- On July 30, 2005, the Moldovan government adopted two decisions: Concerning the confirmation of the key guarantees for the Transnistrian's population and

concerning the regulation of the commodity flows that represent the object of the foreign trade activity of Transnistra;

- Memorandum of Understanding between the EU, the Republic of Moldova and Ukraine on the EU Border Assistance Mission was signed on October 7, 2005;
- EU Border Assistance Mission to Moldova and Ukraine was launched on 30 November 2005 and started its activity on December 1, 2005 for a 2 -year mandate, with the possibility of its extenssion;
- The Common Declaration of the Prime Ministers of the Republic of Moldova and Ukraine of 30 December 2005 on regulation of external economic activity of economic agents from Transnistrian region is in the process of implementation;
- Ukrainian government enforced the Joint Declaration on transit of goods across the Molodvan-Ukrainian border, which was signed by the Prime-ministries of the two countries on 30 November 2005, for the purpose to normalise the procedures of crossing of the goods through border, as well as to fight against smuggling of goods. Under these terms, only the goods that are bearing the official customs specimen of Moldova are able to leave the territory of Transnistria;
- A number of regulations and Government Decisions were adopted regarding the regulations of commodities flows from Transnistria, namely:
  – Government Decision No. 815 of August 2, 2005 concerning the regulation of the commodities flows that represent the object of the foreign trade activity of Transnistria, as amended by the Government Decision, No. February 22, 2006;
  – Government Decision No. 1001 of September 19, 2001 on the declaration of the goods by the economic agents from the Eastern regions of the Republic of Moldova, as amended by the Government Decision No. 48 of 18 January 2006;
  – Government Decision No.299 of 22 March 2006 on amending the Government Decision No.1330 of December 1, 2004 on the adoption of the Regulation concerning the administration procedures of the fiscal obligations of the economic agents located in regions located on the left bank of the river Nistru and in Benderi;
  – The Regulation concerning the procedures for the payment and the refunding of the taxes (fees) paid by the economic agents from the Eastern regions of the Republic of Moldova, adopted by the Ministry of Finance on 15 March 2006;
  – The Declaration of the Moldovan government on 24 March 2006 concerning the recognition of the rights of property of the natural persons and legal entities from Transnistrian region.

Annex 4. Main objectives of the European Commission Border Assistance Mission to the Republic of Moldova and to Ukraine (EUBAM)

- EUBAM is an important signal of the EU's support for Moldova and Ukraine, and for prosperity, stability and security in this region;
- The EU Border Assistance Mission, which started on 1 December 2005 with the participation of experts from 16 Member States, will boost the capacity of the existing Moldovan and Ukrainian border services to carry out effective controls. The main purpose of the mission is to build capacity for border management, including customs, on the whole Moldova-Ukrainian border. This will help to prevent trafficking in people, smuggling of goods, the proliferation of weapons and customs fraud;
- The Border Assistance Mission has a two year mandate, which can be extended. It will cost around EUR 20 million. The Mission has its headquarters in Odessa, and five field offices. It includes 100 experts seconded from EU Member States, as well as some 50 local support staff, bringing the total to nearly 150. Member states that deployed field staff are Austria, Czech Republic, Estonia, Finland, Germany, Greece, Hungary, Italy, Latvia, Lithuania, Netherlands, Poland, Portugal, Slovakia, Sweden, United Kingdom;
- The Mission provides on-the-job training and advice to Moldovan and Ukrainian officials, reinforcing their capacity to carry out effective border and customs controls and border surveillance. The aim is to build confidence and strengthen cross-border co-operation and the exchange of information between the two countries. The Mission operates mainly on the Moldova-Ukraine State border, but also in other relevant inland locations. Border co-operation and efforts to seek a solution to the frozen conflict in Transnistria featured in the European

Neighbourhood Action Plans agreed with both Moldova and Ukraine last year, and the launch of the mission shows the role the ENP is playing in promoting stability and addressing frozen conflicts.

Sources : European Union Factsheet, EU Border Assistance Mission to Moldova and Ukraine, December 2005, http://ue.eu.int/solana

Annex 5. Legal framework in the ENP AP implementation process

Increase of population welfare	• Law No.398-XV of December 2, 2004, approved the Economic Growth and Poverty Reduction Strategy (2004-2006); • Government Decision no.1117, of October 27, 2005, approved the „Concept of the Improvement of Social Assistance System" and the Action Plan for a more efficient granting of nominative indemnities; • Government Decision no. 1119 of October 27, 2005, on the pilot-project on the testing of the provision mechanism of nominative indemnities; • Law on amending the Law on Social Assistance no. 547-XV of December 25, 2003 was approved by the government Decision No. 561 of May 22, 2006; • Law No. 203-XVI of July 6, 2006 on amending the Law No. 499-XIV of 14.07.1999, through which the quantum of the allowance for care of I-degree disabled people from the childhood and of disabled children under the age of 16 was increased; • Government Decision no. 346 of March 23, 2005, for amending The Regulations on Assignment and Payment of Indemnities Meant for Families with Children; • Government Decision no.374 of April 12, 2006 „On amending a number of Government Decisions", the one-off birth indemnity was increased; • Law no.291 as of 17.03.2005 on Indexation of Social Insurance Allowances and of some State Social Allowances; • Law no.363-XVI as of 23.12.2005 on amending the Law 499-XIV as of 14.07.1999 on State Social Allowances for certain Categories of Citizens; • Government Decision no.450 of April 28, 2006, approved the "Minimum Quality Standards on Care, Upbringing and Socialization of the Child from the Temporary Placement Centre"; • Government Decision no. 527 of May 21, 2004, approved the Action Plan "Education for All 2004-2008".

Sustainable increase, consolidation of public funding and settlement of problem of internal debt	• Law on Budget for 2005 No. 373-XV of November 11, 2004; • Government Decision No.1079 of October 19, 2005, on the Medium-Term Expenditure Framework (MTEF) for 2006-2008; • Laws on Amending the Titles I, II, III, IV, V, VII, VIII of the Fiscal Code and the laws for use of these Titles, (laws regulating taxes and fees that are not covered in Fiscal Code); • Draft Title IX „Road Taxes" of the Fiscal Code and the Draft Law for the Use of Title IX of the Fiscal Code; • Government Decision No. 813 of July 11, 2006, on the Draft Medium-Term Expenditure Framework (2007-2009); • Law No.154-XVI as of July 21, 2005 for amending a number f legislative acts, namely Law on the Budgetary System and the Budgetary Process and of the Law on Local Public Finances; • Law No. 249 XVI of October 21, 2005 was adopted on amending the Law on Financial Institutions No. 550-XIII of June 21, 1995, and of Article 24 of the Law No. 199-XIV of November 18, 1998, on Real Estate Market; • Law no. 424-XV of December 16, 2004, on the Re-examination and Improvement of Legal and Normative Framework for Entrepreneurship Activity "The Guillotine Law") in force since February 7, 2005.
Functional market economy	• Government Decision No. 1030 of October 3, 2005, approved the register of official acts for entrepreneurship activity authorization (426), the list of abrogated normative acts (99), the list of normative acts proposed for abrogation by independent structures (7), the list of normative acts that have to be amended and published in the Official Monitor of the Republic of Moldova (285); • Protocol Decision No. 5 of March 23, 2006, "On implementation of reform of state authorization of entrepreneurship activity in 2006"; • Draft Law on basic principles and mechanism for entrepreneurship activity, approved in June 2006 in first reading in the Parliament; • Government Decision No. 920 of August 30, 2005, approved the Nomenclature of Authorizations, Permits and Certificates; • Law No. 1217-XII of June 25, 1997 "On the Privatization Programme", extended till December 31, 2006 by the Parliament; • Government Decision No. 367 of April 11, 2006, for Approving Amendments to a number of Government Decisions and Government Decision No. 400 of April 17, 2006, for Approval of Regulations on Sale of Public Property Share at the Stock Exchange", approved the amendments to the normative acts related to application of privatization methods.
Social and employment policy	• Law 318-XVI of December 15, 2005, on Membership of Moldova to the Optional Protocol to "Convention on Elimination of All Discrimination Forms against Women", adopted in New York on October 6, 1999"; • Law no.5-XVI of February 9, 2006, on Ensuring Equal Chances for Men and Women"; • Draft Law on Prevention and Fight against Domestic Violence; • The Parliament ratified: the ILO Convention No. 185 on Identity Documents of the Sailors, (No. 31-XVI of February 23, 2006); ILO Convention No. 183 on Protection of Maternity (No. 87-XVI of April 20, 2006); Pending: ratification of the ILO Convention No. 150 on Workforce Administration.

Moldova's exports	• Government Decision No. 909 of August 26, 2005, on the competences to issue the preferential certificates of origin.
Customs	• International Convention on Harmonized System for description and codification of goods, signed in Brussels 1983, was ratified; • Government Decision No. 547 of July 7, 2005, "On the approval of the structure maximum staff and the Customs Service Regulation".
Standards and technical regulations	• Draft Law regarding the liability for defective products (EC Directive 85/374/CE); • Draft Law regarding general product safety (EC Directive 2001/95/CE); • Draft Governmental Decision regarding different stages of conformity assessment and regulations of using a conformity mark (Council Decision 93/465/CEE), • Law 327-XVI of 15 December 2005 regarding Republic of Moldova accession to the International Organization of Legal Metrology "Metre Convention" as an associate member; • Government Decision No. 395 April 17, 2006 on approval of the rules related to the conformity assessment procedure for the products from the regulated area and application of rules of the national conformity trade mark SM; • General Regulation RG 29-01-121:2006 „Principles and methodology of conformity assessment. Periodical evaluation of the certified services" • Moldovan Standard SM-45-3:2005 „Principles and methodology of conformity assessment. Certification of the services. General principles" • Moldovan Standard SM-45-2:2005 „Principles and methodology of conformity assessment. Certification of the products. General principles"; • General Regulation RG 29-01-116:2004 „Principles and methodology of conformity assessment. Designation and notification of certification authorities and testing laboratories"; • General Regulation RG 29-01-145:2004 „Principles and methodology of conformity assessment. Application of the national trade mark of conformity SM"; • General Regulation RG 29-01-103:2004 „Principles and methodology of conformity assessment. Periodical evaluation of the certified products"; • General Regulation RG 29-01-147: 2005 regarding "Principles and methodology of conformity evaluation. Insuring conformity through ought producers declaration"; • Governmental Decision No. 586 of June16, 2005, the Regulation, structure and the effective of the Standardization and Metrology Service of Republic of Moldova; • Government Decision No. 859 of 31 July 2006 adopting the "Concept of Quality Infrastructure in the Republic of Moldova"; • Draft Veterinary Law.
Establishment and operation of companies	• Law on insolvency, to enter into force starting with 31 December 2006; • Draft Law on Limited Liability Company; • Draft Law on Joint Stock Company; • Draft Law on individual entrepreneurs; • Law on entrepreneurial patent; • Draft Law on accounting;

Establishment and operation of companies	• Draft Law on audit; • Draft Law on holding companies; • Draft Law on insurance; • Draft Law on vehicle liability insurance; • Draft Law on credit history bureaux; • Draft Law on securities market.
Current Payments and Capital	• Draft Law on Investment Funds; • Law on Anti-Money Laundering, to be amended.
Tax system	• Draft Law on fiscal policy for 2007 was developed to amend a number of provisions of the Fiscal Code and the Law on customs tariff.
State aid	• Law on Competition Protection No. 1103-XIV of 30.06.2000
Intellectual Property	• New draft laws were elaborated: • Draft law on patents for inventions; • Draft law on the protection of trademarks; • Draft law on the protection of origin of goods, of geographical indicati ons and of traditional knowledge; • Draft law on the protection of industrial designs
Public Procurements	• Draft law on Public Procurement.
Statistics	• Law Nr. 412-XV of 09.12.2004 on the official statistics; • Draft Law on amending the Law Nr. 1320-XIII of 25.09.1997 on registers.

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