The specifics of trade relations with the Russian Federation and what are the alternative markets for Moldova?

ECONOMIC ANALYSIS AND FORECAST DOCUMENT

Author:

Iurie Morcotîlo
Adrian Lupușor

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Introduction

The Russian Federation has traditionally been one of the main markets for Moldovan companies. Due to the geographic proximity, common history and the size of its internal market this destination has always held a crucial place in the exports from our country. However, with the Russian Federation external policy activation from the past decade and the change of external vector of Moldova, the political factor started to play the primary role in the bilateral trade relations. Thus, in 2006, as a reaction to the refusal of the Moldovan side to sign and implement the „Kozak Plan" for the resolution of the Transdniestrian conflict, Russia has imposed an embargo on wine exports.

Currently, together with the signing and ratification of the EU Association Agreement (AA) by Moldova, the trade hostilities have re-emerged on the bilateral agenda with Russia. In the current cycle of bilateral disagreements, the range of restrictions was widened, besides wines, including the meat products and fruits. The fact, that the import restrictions have touched only products with excessive exports dependence on the Russian market, is a symbolic gesture. This is, probably, the main reason for extending the restrictive measures, because the wine sector has diversified the exports over the past several years and became less dependent on the Russian market.

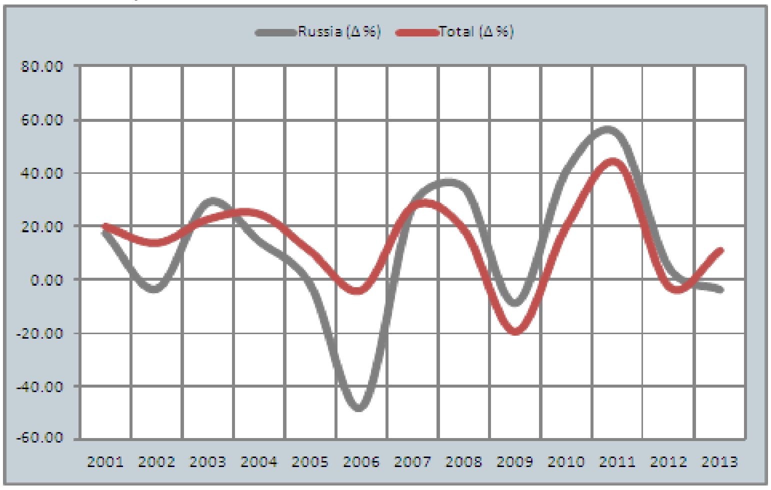
After the bad trade experience of the past decade, Moldova made efforts and diversified the geography of its exports. The main efforts, though, have been directed almost exclusively towards the sector affected by the 2006 embargo – the wine one, some other branches continuing to excessively depend on the Russian Federation markets. This situation leads to a persisting exposure of some important sectors of the national economy to external shocks, of agriculture first of all. Thus, the ad-hoc efforts and measures, taken so far, in order to minimize the consequences of the restrictions introduced by the Russian Federation are the result of omissions in the trade diversification and minimization of external risks policies, more than that, it could have been foreseen an adverse response of the Russian authorities to the signing of the EU AA.

Minimizing the impact of the trade embargo through the geographical diversification of exports remains a strategic objective for Moldova. The search for new markets has to be systematic and consistent, and the main efforts of the authorities and the exporters have to target the markets with the best perspective from the profitability point of view. For this purpose, the present study analyzes the perspectives of alternative markets for restricted products based on several economic indicators, in order to contribute to the process of optimizing the geography of exports and this way reduce the this kind of risks on medium term.

The background of Moldovan-Russian trade relations

The Russian Federation market continues to be the main export destination for products from Moldova. In 2012, the absolute and relative numbers of Moldovan exports have reached their highest values after the 2006 embargo, the share of exports towards the Russian Federation being around 30,3% of the total exports with a value of USD 655,1 ml, so that in 2013 as a consequence of the new embargo it dropped to 26%. Figure 1 shows that the exports' dynamic till 2013 was influenced by the level of the demand on the Russian Federation's internal market, the correlation coefficient of the growth rate dynamics of exports to this country and total exports being fairly high - 0,77. In 2013, though, the exports growth rates had opposite signs which can indicate a possible decupling with the economic cycles of the Russian Federation as a result of intensive diversification (increased range of exported products) and extensive diversification (number and share of other countries) of Moldovan exports.

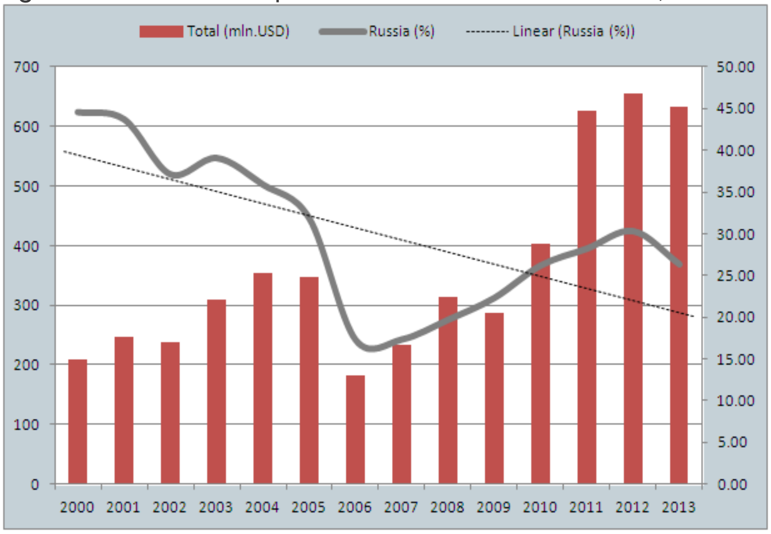
Figure 1. The dynamics of growth rates for total exports and exports to the Russian Federation, %



Source: NBS

Although, in absolute terms, the exports have increased over the past decade, the share of the Russian Federation in our country's exports has significantly decreased, from 45% in 200 to 26% in 2013. Figure 2 clearly shows that the role of the Russian market is constantly diminishing, on medium-term tending towards a share of 20% of the total exports. Trade embargos are just a part of the truth, the main causes being, nevertheless, the exports reorientation towards other markets, mainly to the EU countries, which involves a higher predictability and more opportunities for exporters.

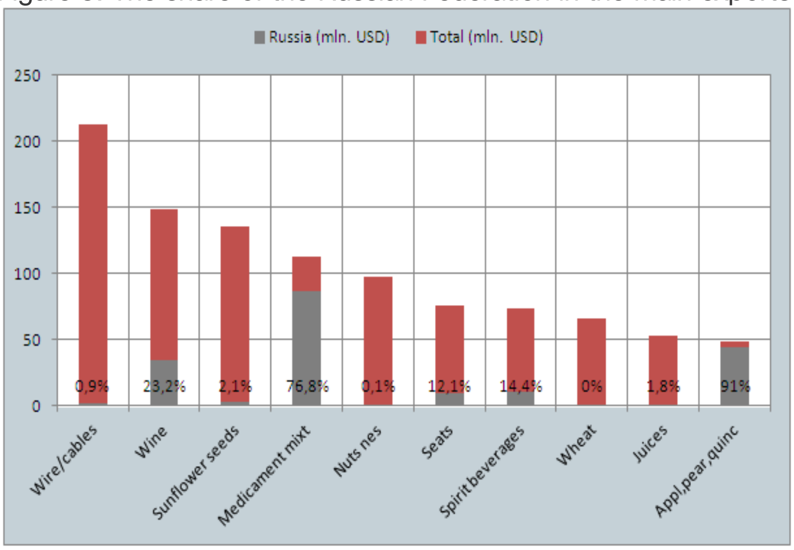
Figure 2. Moldova's Exports to the Russian Federation, absolute and relative numbers



Source: NBS

The decreased importance of the Russian market is also expressed in the structure of exports by products. If we analyze the structure of top-10 exported products (with four figures according to the Harmonized System of Product Nomenclature) in 2013, the share of which is of 42,6%, we see a prevalence of goods exported to other markets rather than to the Russian one (Figure 3). Out of the top-10 exported goods, the Russian Federation market only holds the main role for pharmaceutical products and fruits (apples, pears, quinces). If for drugs re-export is predominant, the acute dependence of fruits can be explained rather through the inertia of the economic entities and public authorities in adopting and implementing international quality standards.

Figure 3. The share of the Russian Federation in the main exports from Moldova (%)

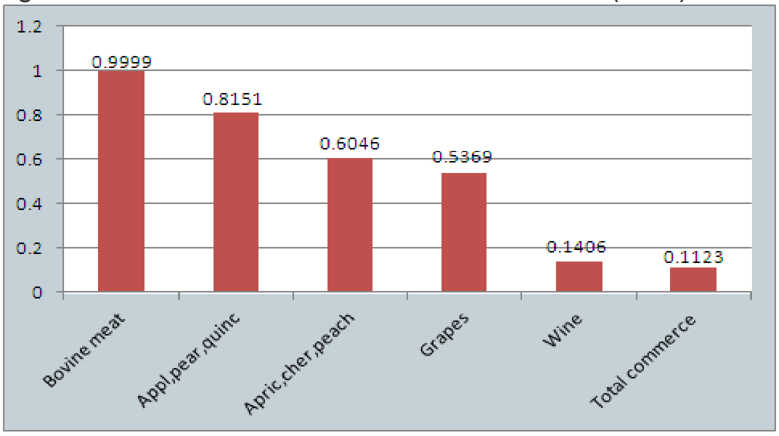


Source: UN Comtrade

Despite the fact, that Moldova has reached a pretty good level of exports diversification over the past several years, there are still some sectors mainly oriented towards the Russian market. This refers especially to the products that have fallen under the last year's trade restrictions – pork meat, canned products, fruits and vegetables. Thus, the dependence on this market is used as leverage over the decision makers from Chisinau.

There is a remaining disparity in the diversification degree of total Moldovan exports and exports oriented towards Russia, which can be quantified with the help of the Herfindahl-Hirshman Index of Market Concentration (HH).[1] Thus, the HH Index at country level is of only 0.1123, this being proof of a satisfactory diversification, while this index has extremely high values for some products – a result of the geographic concentration of exports mainly towards the Russian Federation (Figure 4). In striking contrast with products from the last wave of restrictions, the HH Index for wine has a value of only 0.1406, being explained by the reorientation of the sector towards other markets after the 2006 embargo.

Figure 4. The HH indexes of market concentration (2013)



Source: World Bank

Despite its importance, the Russian market is an unpredictable, politicized one and a reorientation towards other alternative markets is related to the consolidation of Moldova's economic security. In the light of increasing geo-political tension in the region, it is critical to speed up the extensive exports diversification process and to recover the lost opportunities for the sectors that are still closely tied to the Russian market. Moreover, the medium-term economic slow-down in the Russian Federation, with a major risk of sliding into recession is an additional argument for the identification and penetration of other, more profitable markets.

[1] The Herfindahl-Hirshman Index of Market Concentration estimates the ration of trade flows distribution among the external partners of a country. Thus, a country exporting to few external markets has an Index value of almost 1, while a country with a perfect exports distribution portfolio will have an Index that tends to 0.

The analysis of opportunities for Moldovan exports diversification

As a result of initialling the AA between Moldova and the UE at the November 2013 Vilnius Summit, the Moldovan-Russian relations have worsened. First, at the end of the previous year restrictions for Moldovan wines have been introduced, and together with the signing of the AA in June 2014, the list of restricted products was completed with items such as pork meat, fruits, vegetables, canned products, and the trade preferences of the Free Trade Area of the CIS from the Russian Federation were annulled. Also, in the light of the regional instability and increasing trade war risks within the CIS there's a probability of embargo extension over new products, especially those depending on the Russian market. Thus, in order to diminish the consequences of the embargo and capitalize on the opportunities to speed up the exports it is imperative that Moldova identifies new markets for the „blacklisted" products.

In order to maximize the policy efforts in this area, the potential markets must be analyzed from the perspective of several economic parameters, which would objectively indicate if the Moldovan goods could take roots in these new countries. Consequently, each product that was restricted or that is liable for embargo will be analyzed from the perspective of its share in the exports to the Russian Federation, the share of imports of that product on potential markets, the tariff levels, as well as the Revealed Comparative Advantage Index (RCA) for each country[2]. As a result of diagonal comparison of these parameters, it will be possible to identify the most optimal export destinations.

- **Beef was not included in the list of restricted products, but the orientation of exports exclusively towards the Russian market increases the risk of such actions in the future.** Table 1 clearly shows us that 100% of this product's exports are oriented towards the Russian Federation. Still, there are major players on this market that could serve as alternative destinations for Moldovan producers, thanks to the significantly higher Revealed Comparative Advantage Index (RCA) of our country for this product and based on the higher disparity of the RCA several priority countries can be identified, specifically – **Chile, USA, Germany, UK and Italy**. All these countries have a comparative advantage close to the limit (around 1) and their share in global imports is significantly higher than that of the Russian Federation. Moreover, after the EU Accession Agreement enters into force, the identified countries will be able to eliminate both tariff barriers (eliminating import customs taxes), and non-tariff barriers as well, as a result of a potential recognition by EU of the local food safety system and implementation of corresponding quality standards.

Table 1. Comparative analysis of potential markets for beef (2013)[3]

Country	RM exports share (%)	Country share in global imports (%)	Tariff	Total increase of exports for the respective product, 2009-13(%)	RCA
Republic of Moldova					6
Russian Federation	100	2	0	65	0
Canada	0	4,6	26,5	20	2,22
Chile	**0**	**3,5**	**6**	**11**	**0,51**

[2] The Revealed Comparative Advantage Index (RCA) is calculated based on the ratio between the share of a product in the country's exports and the share of trade with this product in total global exports. If this index is higher than 1, then the country has a competitive advantage for this product and vice versa, when it's lower than 1 – there's a competitive disadvantage. Accordingly, trade is facilitated between countries with disparity of these indexes.

[3] If Moldova is excluded from the Free Trade Area of the CIS the tariff for that product will be other than 0. For the EU countries, together with the implementation of the AA provisions, those respective tariffs will be eliminated.

France	0	7,4	71,4	3	2,62
Germany	**0**	**9,2**	**71,4**	**9**	**1,37**
Italy	**0**	**11,5**	**71,4**	**-2**	**0,97**
Netherlands	0	7,9	71,4	7	4,82
UK	**0**	**5,9**	**71,4**	**7**	**1,1**
USA	**0**	**7,8**	**10,9**	**9**	**2,25**

Source: UN Comtrade, ITC, Author's calculations

- **The wine sector has registered the most visible progress in market diversification.** However, the sector remains in strong dependence on the Russian market, and the opportunities presented by the alternative markets have not yet been fully capitalized (Table 2). Over the past several years, Moldova has increased wine exports mainly towards geographically close countries, or those with a minuscule share in the global wine imports, the most eloquent example being Georgia. We export to this country about 7% of the total amount of wine, the paradox being that this country has a comparative advantage equal to our country and a share in global imports of close to 0. From this point of view, the Georgian market is not a profitable one on medium and long term because the exports to this country do not have a solid basis for growth. At the same time, the potential of huge markets with a sustainable growth basis continues to be underused. Among the markets with the greatest perspective we can mention the **USA[4], China, Canada, Germany, Netherlands, Sweden, Belgium and Japan**. These countries are the main wine importers, have a comparative disadvantage for this product and a very small share of wine imports from Moldova.

Table 2. Comparative analysis of potential markets for wine (2013)

Country	RM exports share (%)	Country share in global imports (%)	Tariff	Total increase of exports for the respective product, 2009-13(%)	RCA
Republic of Moldova					43
Belarus	**27,3**	**0,2**	**0**	**6**	**0,04**
Russian Federation	23,2	3,5	0	17	0
Kazakhstan	**9,6**	**0,1**	**0**	**17**	**0**
Ukraine	**7,9**	**0,4**	**0**	**27**	**0,9**
Georgia	7	0	0	68	30,6
Poland	**5,9**	**0,7**	**2,3**	**8**	**0,04**
Czech Republic	**5,5**	**0,7**	**2,3**	**10**	**0,22**
Romania	**3,1**	**0,1**	**2,3**	**28**	**0,23**
China	**2,5**	**4,4**	**14,7**	**37**	**0,01**
Slovakia	**1,3**	**0,3**	**2,3**	**-7**	**0,64**
Germany	**0,8**	**9,5**	**2,3**	**5**	**0,64**
USA	**0,6**	**15,5**	**1,9**	**7**	**0,69**
Japan	**0,1**	**4,5**	**0,1**	**11**	**0**
Belgium	**0,1**	**3,9**	**2,3**	**3**	**0,24**
Canada	**0**	**5,7**	**0,1**	**8**	**0,08**
Sweden	**0**	**2,2**	**2,3**	**5**	**0,14**
Netherlands	**0**	**3,2**	**2,3**	**0**	**0,25**
Switzerland	**0**	**3,6**	**13,4**	**6**	**0,52**

Source: UN Comtrade, ITC, Author's calculations

[4] The Moldovan authorities make efforts to extend on the American market, establishing cooperation relations with the American authorities in order to promote the wine exports to the American market. http://www.maia.gov.md/libview.php?l=ro&idc=52&id=16508

- **Grapes have a more diversified exports structure, the Russian and Belarus markets though taking up most exports.** Due to the zero tariff rates on this product, applied by most key importers, our country has a huge comparative advantage which provides opportunities for reorientation of exports towards new markets. As main alternative destinations we can mention the **UK, Germany, Poland and USA**, these countries consume over 25% of the global imports of grapes, being basically limitless markets for our domestic exporters.

Table 3. Comparative analysis of potential markets for grapes (2013)

Country	RM exports share (%)	Country share in global imports (%)	Tariff	Total increase of exports for the respective product, 2009-13(%)	RCA
Republic of Moldova					48
Russian Federation	74	5,7	0	0	0,09
Belarus	19,8	0,4	0	15	1,49
Romania	4,2	0,2	0	13	0,17
Ukraine	0,9	0,9	0	19	0,03
Poland	**0,3**	**2**	**0**	**4**	**0,9**
Estonia	0,2	0,1	0	4	0,03
Czech Republic	0,2	0,8	0	1	0,46
Netherlands	0	10,5	0	6	8,23
USA	**0**	**13,7**	**0,4**	**0**	**6,3**
UK	**0**	**9,3**	**0**	**5**	**0,43**
Germany	**0**	**8,7**	**0**	**5**	**0,54**

Source: UN Comtrade, ITC, Author's calculations

- **The situation with exports of apricots, sweet cherries, peaches, nectarines and plums is a classic case of dependence on only one market, other markets with even greater potential even within the CIS not being capitalized.** The case of **Kazakhstan** proves it, and the fact that this country holds 2,6% of the global imports for these fruits is ignored by domestic exporters, even within the Free Trade Area of the CIS. There are a series of countries from the EU as well that are on the list of the world's largest importers, have extremely low comparative advantages and an extremely low level of tariff protection. The AA implementation and some efforts from the national line institutions can significantly increase exports in this direction, primarily being highlighted countries such as **China, Germany, Poland, Netherlands and the UK** (Table 4).

Table 4. Comparative analysis of potential markets for apricots, sweet cherries, peaches, nectarines and plums (2013)

Country	RM exports share (%)	Country share in global imports (%)	Tariff	Total increase of exports for the respective product, 2009-13(%)	RCA
Republic of Moldova					48
Russian Federation	80,7	10,4	0	12	0
Belarus	18,1	0,9	0	36	1,36
Romania	**0,6**	**0,4**	**0,2**	**21**	**0,28**
Ukraine	**0,5**	**0,8**	**0**	**16**	**0,27**
Kazakhstan	**0,1**	**2,6**	**0**	**165**	**0,04**
Austria	0	3	0,2	2	2,37
Belgium	**0**	**3,3**	**0,2**	**10**	**0,89**
China	**0**	**6,5**	**11,5**	**66**	**0,12**
Germany	**0**	**14,1**	**0,2**	**8**	**0,18**
Netherlands	**0**	**4,2**	**0,2**	**5**	**0,9**

Poland	0	2	0,2	7	1,33
UK	**0**	**5,8**	**0,2**	**5**	**0,08**

Source: UN Comtrade, ITC, Author's calculations

- **After beef exports, those of apples, pears and quinces depend on the Russian market most of all, 91% of the total amount of these fruits being exported there.** The main market for these fruits, together with the elimination of import tariffs after the AA enters into force could become **Germany**, which is one of the largest importers in the world at this category. Also, the nominal presence on the **UK, USA and UAE** markets can be increased and enhanced with higher return. All countries mentioned above have a comparative disadvantage for these fruits and a zero tariff level, and combined with their significant share in global imports they provide good changes for reorienting the exports from Moldova (Table 5).

Table 5. Comparative analysis of potential markets for apples, pears and quinces (2013)

Country	RM exports share (%)	Country share in global imports (%)	Tariff	Total increase of exports for the respective product, 2009-13(%)	RCA
Republic of Moldova					44
Russian Federation	91	10,4	0	10	0,01
Belarus	4,2	1	0	44	3,58
Kazakhstan	**3,2**	**0,7**	**0**	**8**	**0**
Romania	**0,9**	**0,3**	**5,9**	**16**	**0,21**
UK	**0,1**	**6,9**	**5,9**	**4**	**0,12**
United Arab Emirates	**0,1**	**2,1**	**0**	**14**	**0,22**
Germany	**0**	**8,2**	**5,9**	**5**	**0,19**
USA	**0**	**3,4**	**0**	**6**	**1,88**

Source: UN Comtrade, ITC, Author's calculations

The thorough analysis of international markets for all products restricted by the Russian Federation shows that there are huge opportunities to diversify exports and, thus, the medium-term consequences of the embargo can be minimized. Basically, by orienting its exports only towards the Russian Market, Moldova loses the chances to increase its exports to other markets, larger and more profitable than the Russian one.

Conclusions and policy recommendations

The Russian Federation's Share in Moldovan exports has constantly dropped over the past decade. The impact of trade embargos was not decisive in generating this long-term tendency that will continue in the near future as well, the main role being played by the extensive and intensive diversification of national exports. First of all, a strong geographical shift of exports from Moldova toward the EU took place, and the AA will speed up these processes and will continue to diminish the importance of the eastern markets.

At the same time, the scale of the new embargos has highlighted some omissions in planning the external trade diversification process. The excessive attention to the wine sector has taken the efforts away from diversifying other important sectors that have come to the attention of the authorities only after the new restrictions were introduced. This is why, in order to avoid new restrictions and to reduce the role of politics in bilateral relations, the national authorities have to analyze the entire range of products exported to the Russian Federation, to estimate the degree of market concentration on this market and to identify alternative markets. Thus, identifying the most sensitive products and creating a **systemic diversification plan** for the whole range of sensitive products will lower the probability that such restrictions reoccur in the future, and it will also increase the resilience of those sectors to external shocks.

The analysis of markets for restricted products presented above has highlighted huge opportunities not only for reorienting exports but for increasing their volume on medium term. For all mentioned products new markets have been identified in many EU countries, therefore, signing and implementing the AA provides a new institutional and regulatory framework that can facilitate exports to new destinations. From this perspective, a great deal depends on the public authorities and specifically of the quality of institutions, corruption level, improving the business environment and on the consistent implementation of the agreement provisions will depend how easily the exports will be reoriented and new development opportunities will be capitalized on.

The internal market of the USA is not only a challenge for Moldovan exporters, but it also provides huge opportunities to speed up the exports to this country. The shy initiatives of Moldovan authorities on cooperation with the American ones have to advance and new points of mutual benefit have to be looked into. Thus, for Moldova, in the light of the tendency of complete trade liberalization with the EU, proposing to the American side to negotiate and sign a Free Trade Agreement between our countries would be timely. Moldova's Economy and that of the USA are basically complementary, and as we have seen only for the products analyzed above, there are significant comparative advantages for our country on the American market, and signing such an agreement will facilitate bilateral trade.

Annexes

Annex 1. Main alternative markets for sensitive products in the bilateral Moldovan-Russian trade

Country/Product	Beef	Wine	Grapes	Apricots, cherries, peaches, nectarines, plums	Apples, pears, quinces
Belgium		X			
Canada		X			
Chile	X				
China		X		X	
United Arab Emirates					X
Germany	X	X	X	X	X
Italy	X				
Japan		X			
Kazakhstan				X	
UK	X		X	X	X
Netherlands		X		X	
Poland			X	X	
USA	X	X	X		X
Sweden		X			