The European Union's Neighbourhood programme for the Republic of Moldova

TRADE SECTOR BRIEFS

2015

This publication is financed by the European Union

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TRADE SECTOR BRIEFS

2015

Dear Reader,

It is a great pleasure to introduce this publication on behalf of the project team "Support to the DCFTA process in the Republic of Moldova" (DCFTA project). The EU-Moldova cooperation has grown substantially in recent years both in terms of financial support and in regards to the nature of cooperation. Trade relations between the EU and the Republic of Moldova especially represent an important factor in economic growth of the country, where the European Union (EU) has progressively become Moldova's main trade partner for both imports and exports.

The present series of Trade Sector Briefs seeks to contribute actively to the development and dissemination of knowledge concerning the role of the Deep and Comprehensive Free Trade Area (DCFTA) in the country since the Association Agreement (AA) implementation. The publication provides a comprehensive overview and brings together the results of key trade sectors of the Moldovan economy surveying: (1) Agriculture, (2) Financing, Banking and Insurance Services, (3) Geographical Indications, (4) Competition and State Aid and (5) Light Industry. It follows a structure that gives the opportunity to any reader to understand the existing developments and trends as well as the steps that would need to be undertaken in a specific sector.

The production of the publication is a joint activity between the EU Delegation to the Republic of Moldova, the European Business Association (EBA) of Moldova and the EU-funded project "Support to the DCFTA process in the Republic of Moldova."

We hope this series of Trade Sector Briefs will help you develop a deeper understanding of the EU's trade cooperation with the Republic of Moldova and the work we are engaged in to deepen relations between our respective regions.

Tina GOLFI,
Team Leader
DCFTA project

Table of contents:

1. AGRICULTURE . . . 4
   - 1.1 Brief description of the current situation . . . 4
   - 1.2 Brief description of the EU market . . . 9
   - 1.3 Reference to the Association Agreement/DCFTA . . . 10
   - 1.4 Opportunities and challenges . . . 11
   - 1.5 Projection of future trade flows and trends . . . 11
   - 1.6 Information on the available financial and technical support . . . 12
   - 1.7 Recommendations . . . 12
   - 1.8 Useful links and addresses . . . 13
   - 1.9 Useful terms . . . 13
2. FINANCING, BANKING AND INSURANCE SERVICES . . . 15
   - 2.1 Brief description of the current situation . . . 15
   - 2.2 Brief description of the EU market . . . 17
   - 2.3 Reference to the Association Agreement/DCFTA . . . 17
   - 2.4 Opportunities and challenges . . . 18
   - 2.5 Projection of future trends . . . 18
   - 2.6 Information on the available financial and technical support . . . 19
   - 2.7 Recommendations . . . 19
   - 2.8 Useful links and addresses . . . 19
3. GEOGRAPHICAL INDICATIONS . . . 20
   - 3.1 Brief description of the current situation . . . 20
   - 3.2 Brief description of the EU market . . . 20
   - 3.3 Reference to the Association Agreement/DCFTA . . . 21
   - 3.4 Opportunities and challenges . . . 22
   - 3.5 Projection of future trends . . . 22
   - 3.6 Recommendations . . . 22
   - 3.7 Useful links and addresses . . . 23
4. COMPETITION AND STATE AID . . . 24
   - 4.1 Brief description of the current situation . . . 24
   - 4.2 Brief description of the EU market . . . 25
   - 4.3 Reference to the Association Agreement/DCFTA . . . 26

4.4 Opportunities and challenges . . . 26

4.5 Information on the available financial and technical support . . . 26

4.6 Recommendations . . . 27

4.7 Useful links and addresses . . . 27

5. LIGHT INDUSTRY . . . 28

5.1 Brief description of the current situation . . . 28

5.2 Brief description of the EU market . . . 31

5.3 Reference to the Association Agreement/DCFTA . . . 32

5.4 Opportunities and challenges . . . 32

5.5 Projection of future trends . . . 32

5.6 Information on the available financial and technical support . . . 32

5.7 Recommendations . . . 32

5.8 Useful links and addresses . . . 32

1. AGRICULTURE

Agriculture is one of the most important sectors of the Moldovan economy. It contributes significantly to the country's GDP and represents the basic source of family income for the biggest part of the population, mostly rural. However, the average productivity in the sector is 2-3 times smaller than in Europe. The stability and development of this sector are periodically disturbed by geo-political problems and relations with the traditional main consumer of Moldovan agricultural products (Russia). The start of the implementation of the Deep and Comprehensive Free Trade Area (DCFTA) in September 2014 has already brought some changes to the sector's opportunities. Exports to the EU of the main categories of agricultural products increased in 2014 in comparison with 2013.

The Association Agreement presumes stronger collaboration between Moldova and the EU in terms of development of agricultural policies, based on EU principles, but also enlarges the opportunities for Moldovan producers and exporters and their presence at the EU market. At the same time, the implementation of the DCFTA presents a number of challenges for Moldovan entrepreneurs and the Government.

1.1 Brief description of the current situation

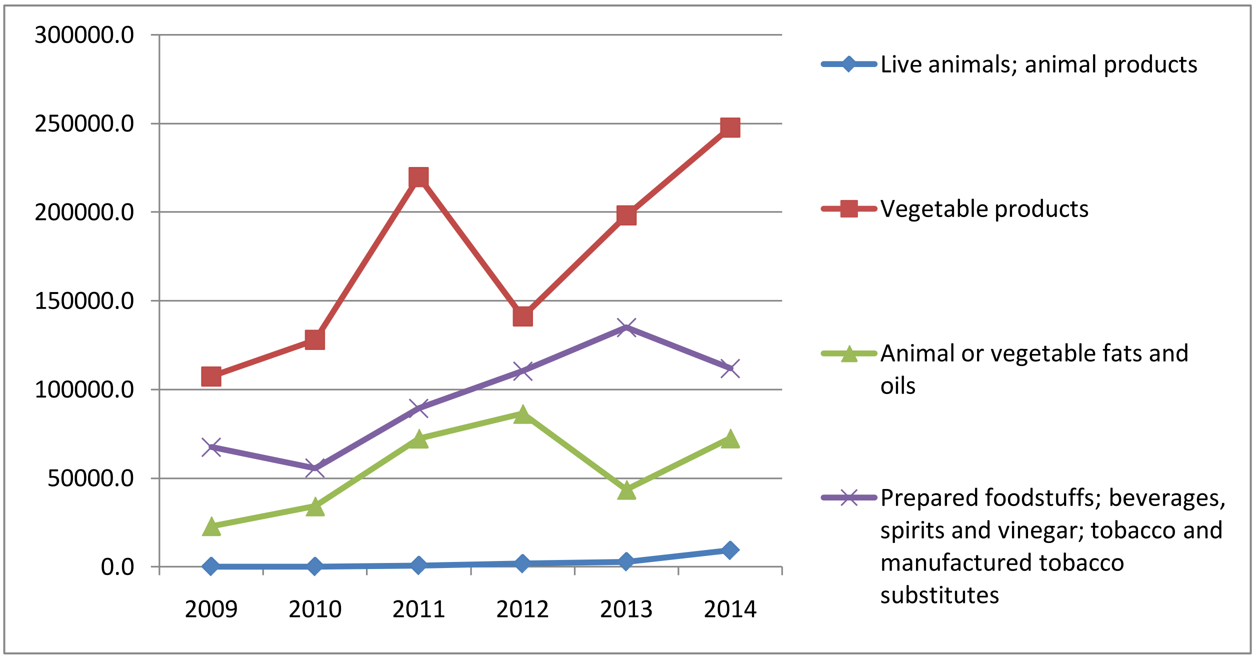
Agriculture is one of the most important sectors of the Moldovan economy. It accounted for about 40% of the country's output in 1989 but its share dropped to about 10% by 2012. Nevertheless, since some 25% of the working population is employed in agriculture, the sector is still important for the national economy.

The EU is the biggest trade partner of Moldova accounting for 53% of total exports and 48% of total imports[1] in 2014. Export of fruit and live animals covers about 17% of total Moldovan exports and stands in third place after manufactured items and machinery.

The dynamics of exports and imports between Moldova and the EU registers a positive trend. The exports of the major categories of agricultural products in 2009-2014 are presented in Figure 1.

[1] http://www.statistica.md/newsview.php?l=ro&idc=168&id=4754&parent=0

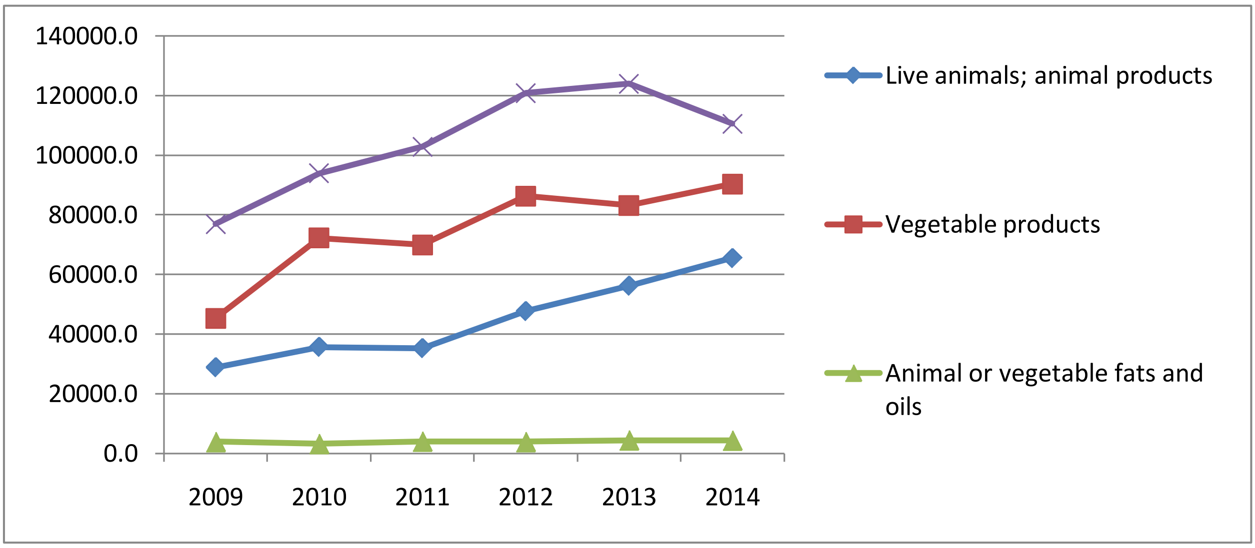
Figure 1. Exports of major categories of agricultural products from Moldova to the EU, 2009-2014, thousands USD



Source: data from the National Bureau of Statistics

Figure 1 shows the growing trend of exports, expressed in USD, in the indicated period of time. Year 2012 makes an exception to the otherwise strong positive growth trend in vegetable products due to complicated weather conditions. Import statistics indicate a similar pattern and are presented in Figure 2.

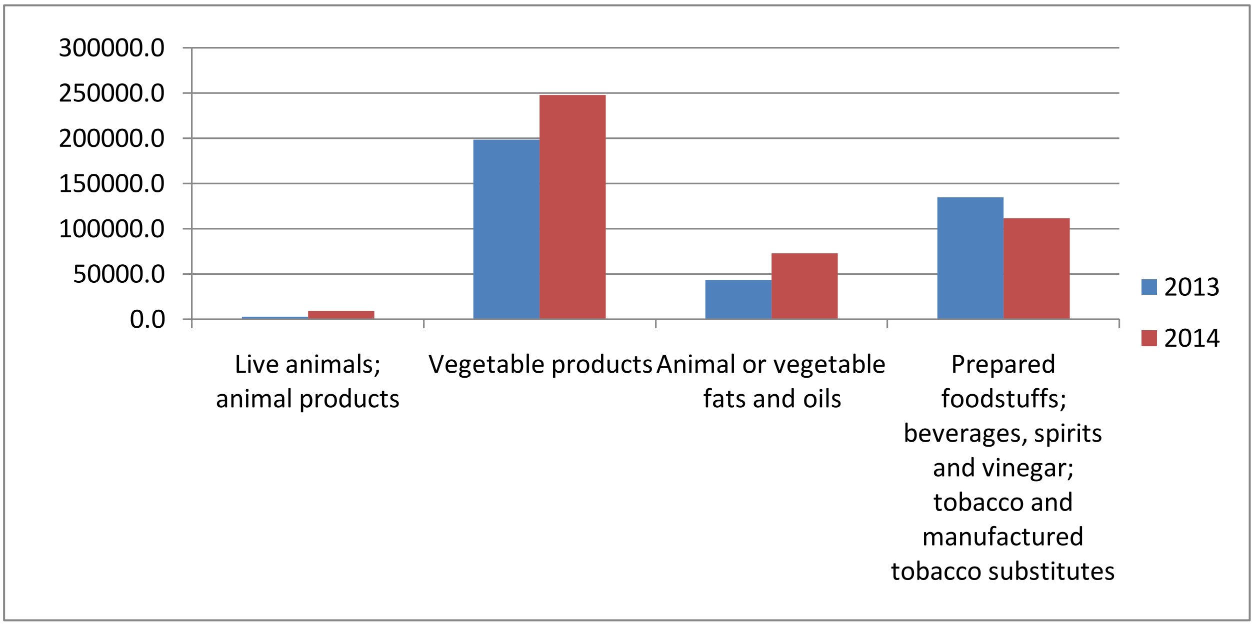
Figure 2. Imports of major categories of agricultural products from the EU to Moldova, 2009-2014, thousands USD



Source: data from the National Bureau of Statistics

The DCFTA started to be applied provisionally in September 2014. The statistical data for 2013 in comparison with the year 2014 shows a visible increase in the exports of the main agricultural groups of products to the EU (with the exception of prepared foodstuffs) (Figure 3).

Figure 3. Exports of major categories of agricultural products from Moldova to the EU in 2013 and 2014, thousands USD



Source: data from the National Bureau of Statistics

Over 1 million tons of ***fresh fruits and vegetables*** is annually produced in Moldova, with 80% of the total production taking place in individual households. In 2013 Moldova produced 416,000 tons of fresh fruits and about 50% of them were exported to the Russian Federation. Not surprisingly in 2014 the whole sector was negatively impacted because of the Russian embargo. The Government offered 138 million Moldovan lei to farmers to compensate for their losses; however, this amount did not cover all needs. Some recent studies are very optimistic about exports to the EU after the introduction of the DCFTA and show that even in September-October 2014 exports of fresh fruits and vegetables exceeded exports for the same period in 2013 (apples – by 2,7 times, plums – by 8,1 times, grapes – by 5,8 times).[2]

The wine industry suffered significantly due to the Russian embargo. As a result, the production of wines in January-October 2014 in comparison with the same period in 2013 constituted 80,3%, and of distillation and mixing of alcohol products – 70,1%.[3] Moldovan exporters of wines also faced the challenge of reorienting their products to the EU market in a very short period of time. The challenge was all the greater as all exports to the EU in the first months of 2014 were declining. In the EU's traditional destinations for Moldovan wines (the Czech Republic and Romania), the volume of sales decreased by 25%, primarily because of high costs for distribution in the EU and poor brand development. The situation demonstrated again the necessity to diversify export markets in order to be better protected from risks, arising from the necessity of such reorientations, which usually take longer periods of time.

However, some sectors performed exceptionally well in this problematic situation, despite external trade shocks. Moldova is one of the world largest producers of ***peeled nuts*** (4th place in the world) and exports about 13,000 tons of peeled nuts each year. It is estimated that the deficit of this product in the EU is at 100,000 tons annually; at the same time almost all of Moldovan nuts (90%) go to the EU market.

[2] Expert-Grup infographic for AGORA.md, http://agora.md/stiri/4669/recomandari-pentru-ca-exporturile-in-ue-sa-mearga-ca-pe-banda-rulanta--infografic-primele-rezultate-ale-acordului-de-asociere-cu-ue

[3] http://www.statistica.md/newsview.php?l=ro&idc=168&id=4580

The Moldovan National Program of Nuts Culture Development targets the production of 16,000 tons annually by 2025.

Moldova is producing annually about 3.5 thousand tons of dried fruits and 80% of exports are oriented to the EU market.[4] Taking into consideration that the EU is a net importer of dried fruits and the volume of imports is growing, this direction has good perspectives for further development.

As mentioned already, the provisional application of the DCFTA brought immediate changes in exports. Some statistical data about the main exported products in 2013 in comparison with 2014 are offered in Table 1.

Table 1. Exports of products from Moldova to the EU, comparative data for 2013-2014, QIII/2013-QIII/2014 and QIV/2013-QIV/2014

Products	2013	2014	QIII/2013	QIII/2014	QIV/2013	QIV/2014
Unprocessed products:						
Nuts/tons	n/a	30,849	n/a	4,643	9,751	19,590
Maize/tons	203,545	446,404	127,223	122,485	56,659	130,710
Processed agricultural products:						
Apple juice/tons	42,673	44,398	8,514	9,272	14,537	19,848
Sunflower oil/tons	51,737	74,574 (up to Nov.)	2,959	1,890	34,751	8,257 (up to Nov.)
Sparkling wines/litres	21,146,806	24,349,287	4,118,820	5,530,698	5,253,572	8,233,132
Sugars	49,013	22,568 (up to Nov.)	10,811	7,773	21,460	6,118 (up to Nov.)
Animal products unprocessed:						
Honey/tons	872	2,561	259	631	431	1,062

Source: data obtained from the Moldovan Customs Service

It can be observed that a significant growth of exports was registered for maize, where export quantity in 2014 almost doubled in comparison to 2013. Under the DCFTA, maize can be imported duty-free up to 130,000 tons; duty-free import of additional amounts is subject to verification of Moldova's evolving production and export capacity. These volumes are more than twice as high as the EU import quotas previously available to Moldova under the Autonomous Trade Preference (ATP). An increase in exports is registered for sunflower oil, honey, and apple juice. Total exports of sparkling wine products increased in the third and the last quarters of 2014 in comparison to the same periods of 2013. The particular data also shows that exports of wines for September-October 2014 are 26% greater than in the same period of 2013.

Despite the restrictions imposed by Russia, export of sugar products to the EU did not grow because sugar prices in the EU are significantly lower than in Russia and competition is very strong due to the subsidies offered to EU producers. Moldovan producers are interested in customers from the Caucasus region and other CIS republics, such as Kazakhstan.

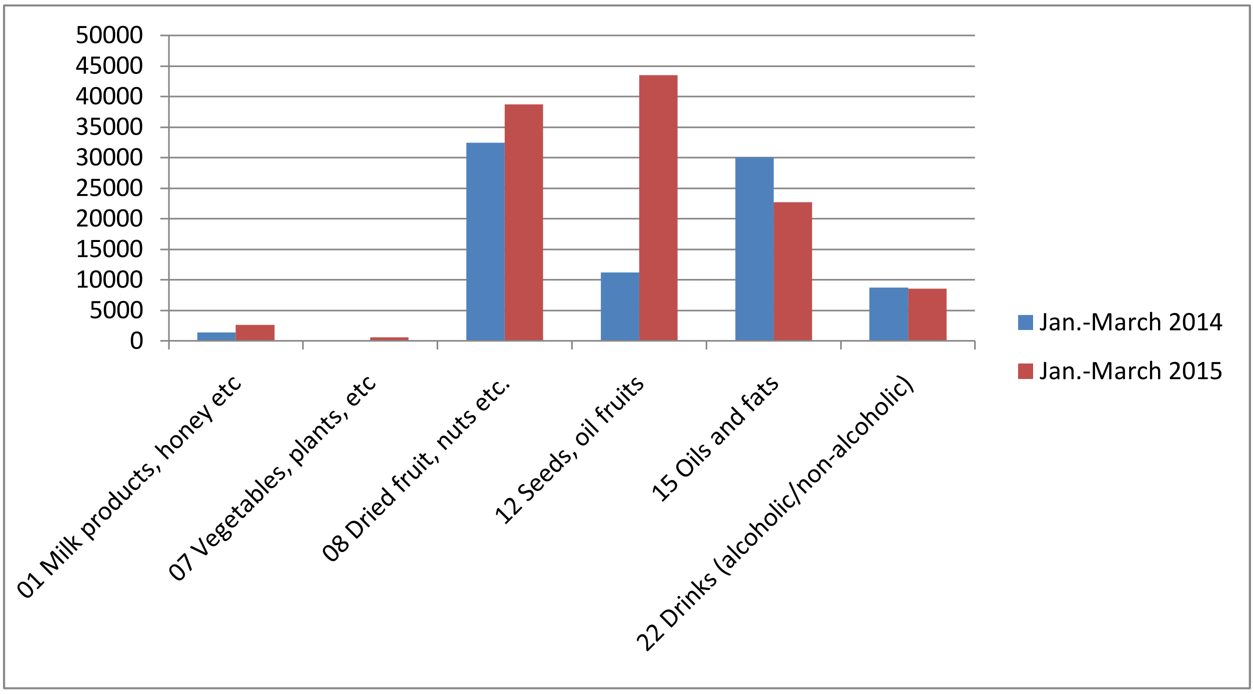
The data illustrates again the general positive trend in exports of Moldovan agricultural products to the EU market.

[4] www.aced.md/publication/download.php?id=24

At the same time, a very specific situation is observed with regard to exports and imports of meat. ***The meat processing*** sector also experienced difficulties because of the Russian trade restrictions. Moldova imports about 60% of raw materials necessary for meat processing, primarily from the EU. At the same time, exports are mainly oriented to the CIS countries. Local meat production is underdeveloped, with the exception of chicken meat. Moldova exports over 20% of their total meat production, primarily beef and mutton, to Arab countries. The main destination for pork meat is the Russian and Belarus markets. Chicken meat is almost totally produced for Moldovan customers; however, lack of sufficient domestic supply of meat causes massive imports of this product from the EU countries. Consequently, only a very small part of local production is oriented to the EU market. In 2014, the quota for exports from Moldova constituted 500 tons of chicken meat. However, this limit was not achieved because of quality standards. Moldova needs urgent renovation of meat processing entities and serious investments in quality control. In this sense, the EUR 100 million credit provided to Moldova by Poland, which is open for applications from May 2015 onwards, is promising.

The promising changes in exports with increasing values for many categories of products continued in 2015. Figure 4 shows the data on exports of some categories of products in January-March 2014 in comparison to the same period of 2015.

Figure 4. Exports of some categories of products (according to NC) to EU in January-March 2014 and January-March 2015, thousands USD

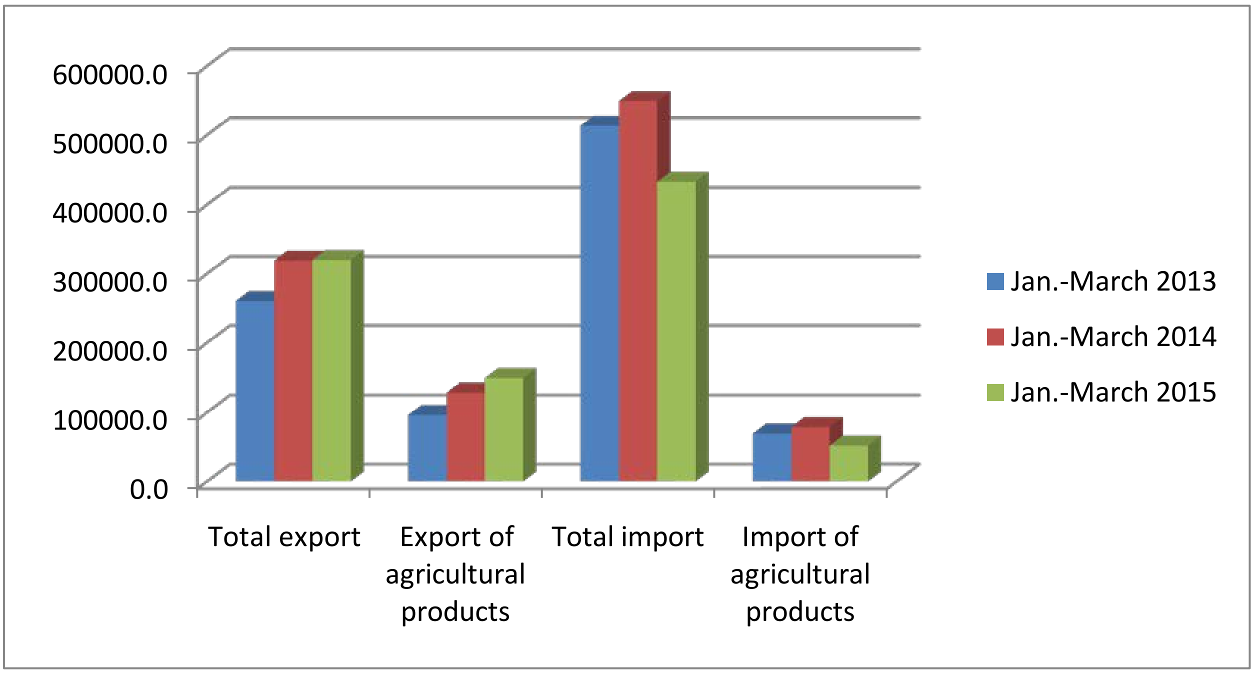


Source: data from the National Bureau of Statistics

Exports of *unprocessed products* (vegetables, plants, seeds and oil fruits) marked a positive evolution, and increased. The same situation is observed for *unprocessed animal products*. *Processed agricultural products* (drinks, oils and fats) registered a lack of progress in terms of exports. Oils and fats even decreased in the analysed period.

These trends characterised the general situation, which is presented in the Figure 5.

Figure 5. Exports and imports in total and for agricultural products in three comparative periods: January-March 2013, 2014, 2015; thousands USD



Source: data from the National bureau of Statistics

Total exports accounted for 318,871.5 thousands USD in January-March 2014 and 319,951.8 thousands USD in the same period of 2015. There is a significant increase in export values for some categories of goods, however, the aggregate export figure for the envisaged period is not significant.

Imports of products from the EU is showing negative growth in 2015 in comparison to January-March 2014, per total and for particular agricultural products.

In conclusion, the situation after DCFTA entered into force for Moldovan agri-food sector products is different than before the DCFTA implementation. For many categories of products export growth was observable in the first months of the DCFTA provisional application in 2014 and continued also in 2015. However, the evolution of trends depends on multiple diverse factors, such as the availability of the product for export, production standards, prices in the EU and provisions of the Association Agreement/DCFTA on import duty elimination or reduction.

Statistical analysis indicates that the *first months of the DCFTA implementation in agricultural trade contributed positively to the trade balance of Moldova and created a significant trade surplus*.

1.2 Brief description of the EU market

Agriculture in the EU is developed within the framework of the Common Agricultural Policy (CAP), which aims to make the EU play a key role in ensuring food safety in the world and, at the same time, ensure that farmers have a reasonable standard of living, while producing quality and affordable food. The diversity and quality of EU agricultural products make the region a major world exporter, but also importer of quality food. The EU imports annually over EUR 60 billion worth of agricultural products from developing countries.

The EU has a series of tools to ensure the quality of products. These are:

- marketing standards;
- a certification system, which ensures compliance with environmental protection, animal welfare, etc.;

- quality systems for products with special quality;
- hygiene rules based on the "from farm to fork" principle.

1.3 Reference to the Association Agreement/DCFTA

Title IV, Chapter 12 of the Association Agreement explains the principles of collaboration between the EU and Moldova in agriculture and rural development. The cooperation should cover the following areas: facilitating mutual understanding on rural policies, enhancing capacities in order to implement EU policies, sharing knowledge, improving competitiveness, etc. A range of Regulations and Directives will have to be taken into account on approximation of Moldovan legislation, for example with regard to the controls of the wine sector, organic agriculture, etc.

According to the provisions of Title V, Articles 143-153 of the Association Agreement and its Annex XV, agricultural products originating from Moldova are exempted from customs duties in different ways:

- The majority of products are imported entirely free of customs duties since the start of implementation of the Agreement. Paragraph 1 of the Annex XV of the Association Agreement stipulates that both the EU and the Republic of Moldova shall eliminate all customs duties on goods originating in the other Party as from the date of entry into force of the Agreement except some categories of goods indicated in the mentioned Annex. Exporters can access the Market Access Database to check the information about their products (web: madb.europa.eu).
- Some products are subject to an import duty (entry price) into the EU with the exemption of the ad valorem component of that import duty (pears, apricots, cherries, peaches, etc.).
- Some products are imported duty free within tariff-rate quotas (apples, plums, tomatoes etc.). A tariff quota represents a volume of goods expressed in quantity or value that can be released for free circulation duty reduction or exemption. The tariff quotas are established for a certain period of time. After this period expires, the goods cannot benefit from reduction or exemption of customs duties. The goods may be imported even if during this period of time the original volume is exhausted, however, this can be done only with the basic customs duties. The allocation request is a request for the application of the reduction or exemption of customs duties under a quota tariff and consists of submitting a customs declaration duly completed and accepted by customs. In this regard, the Moldovan Government approved the Regulation about administration of tariff quotas (Government Decision no. 971 from 17.11.2014). Information about actual tariff quotas is available at the following link: http://www.customs.gov.md/index.php?id=3470.
- Some products are subject to the anti-circumvention mechanism that monitors import levels (pig meat, poultry meat, some dairy products, etc.).
- For some categories the elimination of customs duties will take part gradually at different stages (some categories of jams, juices, wines, etc.).

The DCFTA presumes that no party can introduce new customs fees or increase the existing ones above those established by the Agreement level for goods originated from another party. At the same time, no export fees shall be applied by both parties.

Chapter 4 of the DCFTA part of the Agreement, together with Annexes XVII-XXV, cover the gradual reform process of Moldova's sanitary and phytosanitary measures for agricultural products, which will allow Moldova to export all its agricultural products to the EU. The Moldovan legislation will be gradually harmonised with the EU legislation. Official laboratories have to be accredited at the international and European level and, thus, should be provided will all necessary equipment for the accreditation. Also, the communication and notification system should be implemented (in particular, the RASFF – Rapid Alert System for Food and Feed will be introduced).

Article 175 stipulates requirements for marking and labelling. The Moldovan regulation should correspond to the *acquis communautaire* in this field.

1.4 Opportunities and challenges

As a result of the Association Agreement/DCFTA signed between Moldova and the EU, Russia imposed a series of restrictions on imports from Moldova. This means, practically, that the main markets in the future for Moldovan producers and exporters will be concentrated in the EU countries and the requirements of those markets should be respected. Therefore, Moldovan agriculture needs to introduce ***serious adjustments*** in many spheres, correlated to agriculture per se and agricultural infrastructure in particular.

The Moldovan authorities addressed this challenge from the very beginning. The main authority responsible for the implementation of the state policy and control of agricultural products quality – the National Agency for Food Safety (ANSA) – was not sufficiently prepared for the implementation of the Association Agreement/DCFTA. ANSA and its laboratories are not fully accredited with the EU bodies to issue all necessary certificates for export of agri-food products. Another problem concerns the application of ***GOST system and old standards*** in Moldova. The European Committee for Standardisation issued 378 EU standards in the domain of the agri-food industry. The biggest part of these were accepted by the Republic of Moldova, however, some of these are in contradiction with the GOST standards and the latter should be replaced.

In the National Action Plan for the Implementation of the Association Agreement for 2014-2016, the Moldovan authorities introduced a range of actions. Among them is the acceleration of implementation of EU standards and the cancelling of conflicting national standards. In the period 2014-2020, the authorities will have to adopt annually about 2,500 standards in different spheres; and only 20 standards were adopted in 2014, which indicates a very limited capacity or willingness to implement the plan. At present, European and international standards constitute 35% of their total number while GOSTs – are over 60%.

The sector will also need a series of adjustment measures in order to produce and sell high value-added products. These adjustments include the development of institutional practices related to all export implicated bodies in line with European principles and approaches and, also, investing in modern agricultural infrastructure to process and store the products. Processing of primary agricultural products (for example, drying) should be promoted and developed, taking into consideration the EU market and Moldovan producers' potential, as well as the reduced risks of having to immediately sell dried products in comparison with fresh fruits and vegetables.

1.5 Projection of future trade flows and trends

In order to fulfil the objectives of the Association Agreement and facilitate trade, the Moldovan authorities adopted the National Action Plan for the Implementation of the EU-Moldova Association Agreement. It is expected that its stipulations, in line with the active efforts of the Government, will increase trade flows between the EU and Moldova. Together with the reduction/elimination of import duties on bilateral trade, an independent study[5] predicted that the reforms process of the Association Agreement/DCFTA will result in a growth of trade, namely by 16% for exports and 8% for imports, adding 5.4% to Moldova's annual GDP growth.

[5] ECORYS, Trade Sustainability Impact Assessment in support of negotiations of a DCFTA between the EU and Georgia and the Republic of Moldova, November 2012.

1.6 Information on the available financial and technical support

On a recently created web site www.finantare.gov.md, the Moldovan Government announces all financial and technical support sources available for producers and exporters. The information is divided into sections: grants, financial guarantees, leasing and credits and different stages for the development of entities.

The Moldovan Government distributes annually via the program of agricultural subsidies about EUR 27 million. The Moldovan Agency for Interventions and Payment in Agriculture (AIPA) was created in 2010 in order to distribute these resources to support agricultural producers. The main problem of this programme is that there are too many support measures to cover with a very limited amount of resources, which causes inadequate compensation of producers' expenses.

The National Strategy of Agricultural and Rural Development for 2014-2020 is based on three priorities:

- increase competitiveness in the agri-food sector;
- improvement of living standards in rural areas;
- sustainable management of natural resources.

The implementation of this strategy takes place with the following support measures:

- ENPARD Program (EUR 64 million);
- DCFTA Program (EUR 30 million);
- Consolidated Programs Implementation Unit IFAD (UNICEF-IFAD) was created by the Government to implement programs of the International Fund for Agricultural Development (IFAD). IFAD provides direct financing through low-interest loans and grants and attracts additional co-financing for implementation and collaboration in IFAG-initiated projects and programs (about EUR 24 million);
- World Bank and EBRD programs (EUR 200 million);
- USAID (EUR 160 million);
- Credit of the Polish Government (EUR 100 million);
- AIPA Regulation, subsidy application forms and instructions available at www.aipa.gov.md;
- Eco fund – Ministry of Environment;
- Other programmes.[6]

1.7 Recommendations

In order to successfully implement the DCFTA and develop its agriculture in a sustainable way, the Republic of Moldova has to adopt and promote the following initiatives. The recommendations to the authorities include:

1. Development and modernisation of the post-harvest infrastructure which will offer to the Moldovan exporters the possibility to meet EU standards and requirements regarding packaging, marketing and the distribution of agricultural products to the EU market.
2. Enlargement of support in export procedures, starting from consultancy and information and up to technical assistance in the promotion of agri-food networks on local markets and relations with importers.

[6] www.finantare.gov.md

3. Facilitation of modern financial instruments. Taking into consideration that EU funds (ENPARD) are distributed on a post-investment basis, agricultural producers need credits and loans at lower interest rates and longer grace periods.
4. Creation of a guarantee fund for loans on co-financing programs would enhance resource mobilisation.
5. The Republic of Moldova has to liberalise the imports of new agricultural plant species. At present, the list of species admitted is not competitive with other EU countries.
6. Modernisation and introduction of quality standards in meat processing and production of meat and meat products is important and should be supported.
7. Moldova needs urgently to adopt EU standards in agri-food production. Old standards are not reflecting actual conditions. National standard bodies have to collaborate more actively with European and international organisations in the field.

Entrepreneurs (producers and exporters) also have to undertake active measures in order to be able to trade on EU markets. Particular recommendations include:

1. Local producers have to create associations, which would represent them on different levels and help create distribution networks for export.
2. Producers and exporters have to participate in programs and seminars in order to develop their skills and learn EU practices.
3. Emphasis should be placed on high value-added products, and this segment of production should be further developed. This would help not only to accumulate revenues, but also protect from potential threats to exports, if any arise.
4. Producers and exporters should work closely with Moldovan authorities to help identify the needs and constraints of the agri-food sector.

1.8 Useful links and addresses

1. The European Union Explained: Agriculture. EC DG for Communication, 2014. Retrieved from: http://europa.eu/pol/pdf/flipbook/en/agriculture_en.pdf
2. National Agency for Food Safety, www.ansa.gov.md
3. Agency for Interventions and Payments in Agriculture www.aipa.gov.md
4. Regulation no. 581/2011 of the European Parliament and of the Council of 8 June 2011 amending Council Regulation (EC) no. 55/2008 introducing autonomous trade preferences for the Republic of Moldova,http://eur-lex.europa.eu/legal content/EN/TXT/PDF/?uri=uriserv:OJ.L_.2011.165.01.0005.01.ENG

1.9 Useful terms

Acquis communautaire or the ***Community acquis***: (French: *acquis* meaning "that which has been acquired or obtained", and *communautaire* meaning "of the community") is the accumulated legislation, legal acts, and court decisions which constitute the body of European Union law.

Anti-circumvention mechanism: for the Republic of Moldova presumes that when the level of imports of products under this mechanism covers 70% of the volume indicated in the Annex XV-C of the Agreement, the EU will inform Moldovan authorities about this and within 14 days the Moldovan party will have to justify and argue for the increase of imports. If this justification is not proposed, than the EU can temporarily (for 6 months) suspend the preferential treatment of those products.

Autonomous trade preferences (ATPs): for the Republic of Moldova were originally introduced by the EU through Council Regulation (EC) no. 55/2008 of 21 January 2008 ("ATP Regulation"). The granting of such preferences was foreseen under the European Neighbourhood Policy Action Plan of 2005 and was conditional upon substantial improvements by Moldova of its system of controls and certification of goods. Moldova delivered on its commitments by reforming its customs legislation and satisfactorily translating it into administrative practice by 2007. EU ATPs were therefore granted to Moldova as of January 2008 for a period until 31 December 2015. ATPs replaced the GSP+ preferences that the EU had granted Moldova in the context of the EU GSP scheme. As compared to GSP+ preferences, the ATP Regulation removed all the remaining duties for Moldovan industrial products and improved access to the EU market for Moldovan agricultural products. As a consequence all products originating in Moldova were granted free access to the EU market, except for certain agricultural products listed in Annex I to the ATP Regulation (mainly beef and pork, poultry, dairy products, maize, barley, sugar).

Entry Price System: applies to all fruit and vegetables from all exporting countries outside the EU and represents the price on the basis of which the customs clearance will be calculated either as to the invoice for the individual consignment, or the Standard Import Value, which is published by the European Commission per product and per country of origin every day.[7]

[7] http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2014.115.01.0022.01.ENG

2. FINANCING, BANKING AND INSURANCE SERVICES

The finance sector of the Republic of Moldova is heavily dominated by banks. Capital markets, insurance services and other sub-sectors are weak and underdeveloped. Despite relatively good results in profitability and market presence, the banking sector is experiencing severe problems with fair competition (in one of the latest studies, presented by the World Bank, it stands in the first place as the most problematic sector from the competition point of view). Proper enforcement of the legislation is also mentioned as one of the basic problems by local and international experts.

According to the Association Agreement, Moldova should implement internationally agreed standards in the sphere of financial services and EU Directives, related to banking supervision, and the fight against money laundering etc. In particular, Moldova has to improve and strengthen the administrative capacity of the National Bank of Moldova as a result of the implementation of the Twinning project "Strengthening the capacity of the National Bank of Moldova in the field of banking regulation and supervision in regards to the implementation of the requirements of the Basel II/III Agreement", modify the Law of financial institutions, the regulation related to the capital risk, etc. (according to the National Action Plan for the implementation of the RM-EU Association Agreement, approved by Government Decision on October 7, 2014).

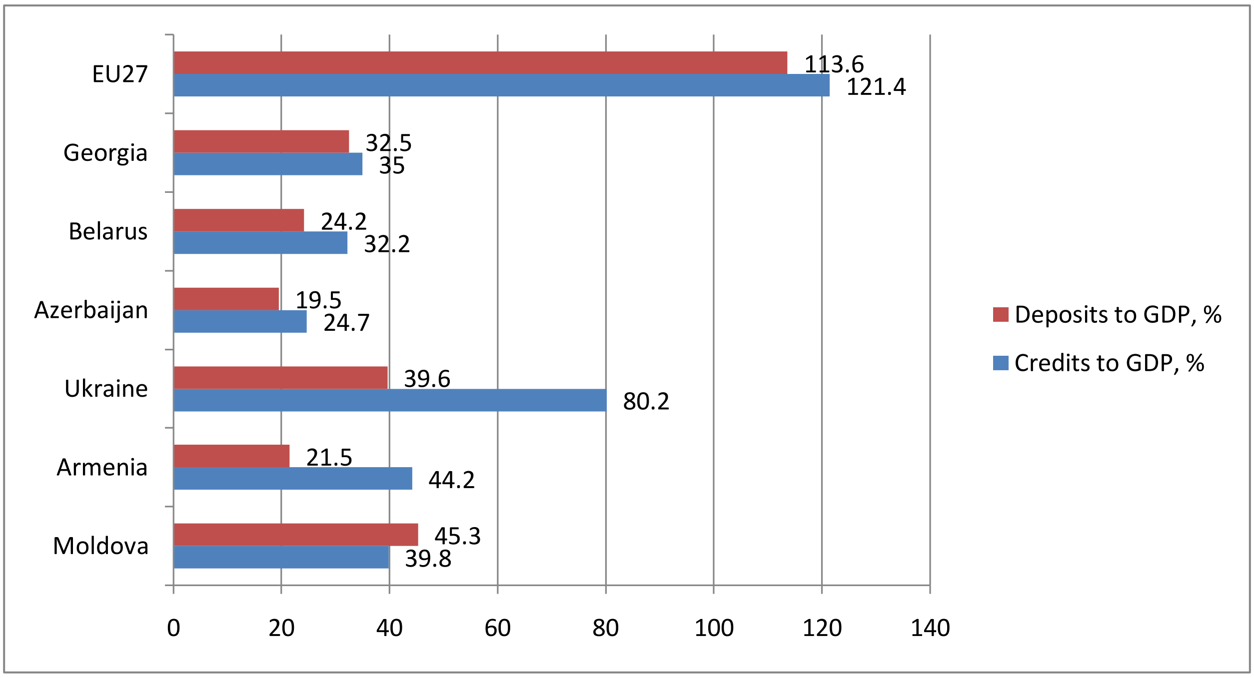
2.1 Brief description of the current situation

The financial sector in Moldova is relatively developed compared with other economic areas but lags behind the financial sectors in most of Central and Eastern Europe. The financial intermediation level in Moldova is very low compared to other countries. This affects non-bank financial services in particular, with insurance services (including pensions) being the most problematic subsector because of bad conditions and adverse demographic projections. Insurance penetration remains low at 1.24% and the availability of insurance products is also very limited. There are about 60 microfinance institutions and over 500 savings and credit associations. The Capital market is not developed and access to the international capital market is limited. The leasing sector is weakly developed as well, and the top 3 companies control over 50% of the market. Therefore, the Moldovan financial sector is ***heavily dominated by banks***.

The financial sector is regulated by the National Bank of Moldova (for banking) and the National Commission for Financial Markets (for non-banking). The World Bank and International Monetary Fund (IMF) initiated a programme of evaluation of the financial sector of Moldova (FSAP program). This programme is intended to identify measures to reduce the financial sector's vulnerability and improve policies, including those related to banking activity.

The fundamental challenge in the financial services sector is to adopt a range of international standards set by the IMF, the Basel Committee on Banking Supervision, the International Association of Insurance Supervisors, the International Organisation of Securities Commissions, in addition to the EU standards. It is very complicated for Moldova to adopt these standards, given their complexity and major economic implications. A comparative analysis of financial intermediation shows that Moldova is currently at the level of regional countries at similar stages of development, surpassing countries such as Armenia, Belarus and Georgia, but below the EU average.

Figure 6. Level of financial intermediation in Moldova and countries in the region in 2012



Source: ERD Country Illustration Workshop, Chisinau, 15 May 2014

Moldova's banking system accounted for 93% of total financial assets provided and 96% of total loans provided by the financial sector at the end of 2012. However, access to banking services is limited and business activities are seldom financed from banking sources, which are expensive and rarely available for long-term periods due to:

- limited availability of longer loan maturities for funding capital investments;
- inflation and high credit rate risks;
- risk of doing business in Moldova;
- high collateral requirements;
- relatively high levels of interest rates and commissions on borrowing;
- Moldovan banks have a strong preference for maintaining liquidity.

The Moldovan financial sector and banking in particular is associated with high risks. Some recent evolutions are very alarming. A large capital gap appeared as a result of dubious transactions in the banking sector. In the end of 2014, three Moldovan banks – Banca de Economii, Unibank and Banca Sociala, were placed under special administration. Whereas the minimum limit for principle 2 on current liquidity is 20%, in February 2015 this indicator was much lower in Banca de Economii (-3.6%), Unibank (8.2%) and Banca Sociala (-69.2%). As a result of these suspicious transactions, large amounts of foreign currency were subtracted from the market and the national currency depreciated very significantly. Despite all these conditions, the Moldovan authorities hesitated to be decisive in taking action. The Law on Financial Institutions expressly provides that the National Bank may limit the bank's activities (Article 38, paragraph 1(f)) and may restrict, suspend or prohibit certain transactions or operations (Article 38, paragraph 2) if the interests of depositors are jeopardised or if the bank is engaged in risky or suspicious operations. The delayed reactions put the efficiency of governance of the financial system under serious question. The Government contracted a foreign company to investigate the fraud related to those three banks; however, the much anticipated report did not indicate the exact beneficiaries of the questionable transactions.

In 2013, some other negative phenomena took place in the Moldovan banking sector. The most important banks (Banca de Economii, Moldova Agroindbank and Victoriabank) were implicated in disputes about questionable transactions, fraud or so-called, “raider attacks”. Several government officials were dismissed, being accused of the inability to react. Victoriabank, the first commercial bank in Moldova was also associated with a “raider attack”. These hostile takeovers are characterised by a rapid transfer of ownership of shares to individuals and companies in blocks below the 5% change of control threshold (recently amended to 1%). Thus, while aggregate banking performance indicators show positive trends, significant risks exist due to credit quality and capital adequacy at some banking institutions. Weak governance, lack of shareholder transparency and the protection of property rights are other stringent problems for some banks.

One of the major factors is the quality of regulation in terms of protecting competition and combating corruption. According to some unofficial estimates, over 70% of the Moldovan financial sector is concentrated in one group. Officially, 70% of banking sector assets belongs to the five biggest commercial banks.[8] These and other issues must be addressed in order to improve the financial and particularly the banking sector in Moldova.

As a result of the situation in 2014 with the three problematic banks and increasing interest rates, banking lending activity decreased dramatically. The lack of confidence in public institutions became more profound.

In addition, in June 2015 three other commercial banks were placed under special supervision. The worsening of general economic conditions in 2015 will cause the reduction of revenues for entities and individual persons and, probably, will cause serious difficulties in loan repayment, aggravated by the depreciation of the national currency.

2.2 Brief description of the EU market

Since 2008, the European Union and its Member States have engaged in a fundamental overhaul of bank regulation and supervision. This process includes the introduction of reforms to reduce the impact of potential bank failures, with the objectives of creating a safer financial system, through the adoption of new rules on capital requirements for banks and bank recovery and by launching the Banking Union. In 2013, the EU adopted a legislative package about the Basel 3 implementation in Europe. The package entered into force on 1 January 2014. Therefore, the choice became more complicated for Moldova. On the one hand, the country will have to harmonise its legislation. One the other hand, one of the biggest difficulties in this sense is related to the ongoing nature of regulatory reforms in Europe. Europe per se is passing through major reforms in its banking sector regulation and concomitantly those new rules have to be transposed for Moldova. The Republic of Moldova is going to face an unprecedented challenging process in the future, while following the legal approximation process in the area of banking and financial regulation in a time when this regulation is simultaneously being introduced in Europe.

2.3 Reference to the Association Agreement/DCFTA

Chapter 9 of Title IV recognises basic principles of collaboration in the area of financial services and their adaptation to the needs of the market economy by implementing EU legislation in the areas of strengthening cooperation with the Financial Action Task Force (FATF), the Council of Europe, the Committee of Experts on the Evaluation of Anti-Money Laundering Measures and the Financing of Terrorism (MONEYVAL), and any other relevant authorities in EU Member States.

[8] Francois and Schuknecht. International Trade in Financial Services, Competition and Growth Performance, 2000.

Art. 241-249, Title V of the Association Agreement refers to the principles of the regulatory framework for financial services. In particular, it is important that Parties should implement internationally agreed standards in the sphere of financial services.

The Republic of Moldova will have to implement a series of regulations and EU directives in the field, for example:

1. Regulation (CE) no. 1781/2006 of 15 November 2006 on information on the payer accompanying transfers of funds. Normative acts of the National Bank have to be harmonised within 3 years from the beginning of implementation of the Association Agreement;
2. EU Directive 2013/36/EU and Regulation (CE) 575/2013 and initiate the modification of Law of Financial Institutions, rules for banking supervision, etc.;
3. EU Directives 2005/60/CE and 2006/70/CE and elaborate or modify existing normative acts with regard to money laundering;
4. EU Directive 2003/41/CE about pension funds and their promotion.

In order to ensure effective and independent supervision, as the Agreement presumes, Moldova has to improve and strengthen the administrative capacity of the National Bank of Moldova as a result of implementation of the Twinning project "Strengthening the capacity of the National Bank of Moldova in the field of banking regulation and supervision in regards to the implementation of the requirements of the Basel II/III Agreement" and evaluate the capacity of the banking supervisor and strengthen its capacity as a result of the implementation of the project.

2.4 Opportunities and challenges

Despite the fact that the banking system has been opened to foreign competition, the foreign presence in the Moldovan banking system is still low compared to other countries in the region. During the last three years some Moldovan banks have experienced very unpleasant processes of being included in disputes and scandals, which negatively impacted the general attitude towards all banks. There is a reasonable hope that the Agreement and the policies to be adopted in order to fulfil the respective obligations will bring more chances for quality improvement in banking competition and will increase globally the opportunities for development and growth.

At the same time, implementation of EU Regulations and Directives can stimulate the development of other segments of the financial sector, such as pension funds.

Separate attention should be paid to strengthening the capacities of the state regulators, NBM and NCFM. At the same time, serious reforms should be undertaken in the shareholders' transparency and liability.

Moldova will have to adopt all necessary acts on prevention and the fight against money laundering. The main challenge in this direction relates to the fact that this process requires specific skills and knowledge of the collaborators of the National Anti-Corruption Centre and close collaboration with the National Bank.

2.5 Projection of future trends

Several econometric studies have recently been undertaken on the impact of service sector reform and liberalisation on GDP growth. For financial services, Francois and Schuknecht (2000)[9] find that financial sector openness (i.e. the presence of foreign banks in the domestic market, not necessarily involving capital account liberalisation) is strongly and positively associated with competition in the sector; furthermore, competition is strongly associated with economic growth, on top of the separate effect of financial sector

[9] http://particip.gov.md/categoryview.php?cat=202&l=ro

development on growth. In other words, a highly competitive and highly developed financial sector is associated with a higher GDP growth rate than a less competitive and similarly developed sector. It is expected, therefore, that the DCFTA between Moldova and the EU will lead to further successful services liberalisation and institutional reforms in the sector.

2.6 Information on the available financial and technical support

1. MIGA's project for the improvement of access to financing and developing new products (6.5 million USD), www.miga.org;
2. The IMF supported the adoption and coming in force of the new Law for Financial Institutions.

2.7 Recommendations

Major recommendations for the sector relate to the following measures, and are primarily the responsibility of state regulation bodies:

1. proper enforcement of banking and financial regulation, which is only possible in conditions of a functioning judicial system and rule of law;
2. promotion and development of insurance and leasing products;
3. changing the approach to financial sector supervision and placing emphasis on the efficiency of investigating the shadow transactions in the banking system;
4. timely implementation of the provisions of the Association Agreement would contribute to sector transparency and efficiency;
5. participants in the sector from the entrepreneur's side are recommended to participate actively in the development and modification of legislation in the field via their professional associations or business associations. The voice of private entities is vitally important for progress in this direction.

2.8 Useful links and addresses

1. National Commission for Financial Markets: www.cnpf.md
2. National Bank of Moldova: www.bnm.md

3. GEOGRAPHICAL INDICATIONS

Protection of geographical indications is guaranteed by the national law. Also, the Lisbon Agreement for the Protection of Appellations of Origin stipulated a 5-year period for the Republic of Moldova (starting from 1 April 2013) to put in place all actions to stop any unlawful use of Protected Geographical Indications including measures at customs borders.

The Association Agreement indicates that Moldova shall protect the geographical indications of the EU and the EU similarly has to protect the geographical indications of the Republic of Moldova.

It is highly recommended to the Government of Moldova to promote this mechanism in order to give the opportunity for entrepreneurs to benefit from exploitation of the protected geographical indications in the future.

3.1 Brief description of the current situation

Designations of origin and geographical indicators are protected in the Republic of Moldova according to the Law no. 66-XVI of 27.03.2008 about protection of geographical indications, designations of origin and traditional specialities guaranteed, and Law no. 101 of 12.06.2014 about approval of national symbols related to protected designations of origin, protected geographical indicators and traditional specialities guaranteed. Government Decision no. 551 of 07.06.2005 addresses measures for production of wines with traditional names, and Government Decision no. 1366 of 01.12.2006 addresses the delimitation of wine production areas related to these issues. Moldova respects the Paris Convention for the Protection of Industrial Property, the Nice Arrangement on International Classification of Goods and Services and the Lisbon Agreement for the Protection of Appellations of Origin and their International Registration.

The Government Decision no. 969 of 4 December 2013 stipulates the nominal composition of the EU-Moldova Committee on protection of geographical indications for agricultural and food products and in January 2014 Moldovan delegation participated in the meeting.

According to the AGEPI data (State Agency for Intellectual Property of Moldova), at present two trademarks are registered in Moldova as Protected Designation of Origin and four as Protected Geographical Indicators.[10] At the same time, some geographical indicators are protected by specific laws (Law no. 322-XV of 18.07.2003 for “Cricova” and Law no. 199-XVI of 28.07.2005 for “Milestii Mici”). However, the number of applicants and protected designations is very small and there is ample space for growth in this direction.

The Lisbon Agreement for the Protection of Appellations of Origin stipulated a 5-year period for the Republic of Moldova (starting from 1 April 2013) to put in place all actions to stop any unlawful use of Protected Geographical Indications including measures at customs borders.

3.2 Brief description of the EU market

In the EU, the law provides the rules for protecting designations of origin and geographical indications for agricultural products and foodstuffs intended for human consumption as well as wines and spirits.[11]

[10] http://www.db.agepi.md/GeogrIndications/DeciziiEmise.aspx

[11] Regulation (EU) no. 1151/2012 of the European Parliament and of the Council of 21 November 2012 on quality schemes for agricultural products and foodstuffs. Specific rules for wines: Regulation (EU) no. 1308/2013 of the European Parliament and of the Council of 17 December 2013 establishing a common organisation of the markets in agricultural products and repealing Council Regulations (EEC) no. 922/72, (EEC) no. 234/79, (EC) no. 1037/2001 and (EC) no. 1234/2007

According to EU Regulation no. 1151/2012, *protection should be equally available to designations of origin and geographical indications of third countries that meet the corresponding criteria and that are protected in their country of origin. Registration as designations of origin, geographical indications and guaranteed traditional specialities should be open to names that relate to products originating in third countries and that satisfy the conditions laid down by this Regulation.*[12]

EU has a special system to identify products with special quality. These are:

Protected Designation of Origin (PDO), which gives status to a food product which is produced entirely within a defined geographical area using recognised skills and ingredients from the region and which is linked to its geographical origin. This includes many cheeses (such as Queso Manchego or Feta), meat products (such as Prosciutto di S. Daniele), olive oil (Umbria, Kalamata, Montoro-Adamuz), fruits and vegetables and many wines. In order to receive the PDO status, the product must fulfil specific requirements: in particular PDO should correspond to the name which identified a product (a) originating in a specific place, region or, in exceptional cases, a country (b) whose quality or characteristics are essentially or exclusively due to a particular geographical environment and (c) the production steps of which all take place in the defined geographical area.

Protected Geographical Indication (PGI) denotes a food linked by its quality and reputation to a region in which at least one stage of production took place. This includes beers (Münchener Bier, Ceskobudejovické Pivo), meat (Scotch beef, many types of French poultry), spirits (Scotch Whiskey, Calvados) and also bakery products and fish (notably Scottish farmed salmon). To receive the PGI status, the product must fulfil precise requirements: in particular PGI should correspond to the name which identifies a product (a) originating in a specific place, region or country (b) whose given quality, reputation or other characteristic is essentially attributable to its geographical origin and (c) at least one of the production steps takes place in the defined geographical area.

Traditional Specialities Guaranteed (TSG) aims to provide a protection regime for traditional food products of specific character. PDO and PGI are related to geographical locations, TSG – to traditional products.

The widespread conviction that the promotion of products with a strong geographical connotation has now become a strategic factor for the development of the European agro-food system and has led to a marked increase in the number of food products with denominations of origin and geographical indication in Europe during the last decade. A continuous effort is needed to improve the recognition of the PDO and PGI graphic logo among other brands and logos that promote local origin of food products and to establish a coherent and clear promotion strategy.

3.3 Reference to the Association Agreement/DCFTA

The Intellectual Property Rights chapter of the DCFTA in the Association Agreement includes in full the EU-Moldova Agreement on Geographical Indications, which was already applied as a separate agreement since April 2013. It was then included in the DCFTA part of the EU-Moldova Association Agreement. It underlines that the Parties should protect and enforce the protection of geographical indications.

Commission regulation (EC) no. 607/2009 of 14 July 2009 laying down certain detailed rules for the implementation of Council Regulation (EC) no. 479/2008 as regards protected designations of origin and geographical indications, traditional terms, labelling and presentation of certain wine sector products

Specific rules for spirits:

Regulation (EC) no. 110/2008 of the European Parliament and of the Council of 15 January 2008 on the definition, description, presentation, labelling and the protection of geographical indications of spirit drinks and repealing Council Regulation (EEC) no.1576/89

[12] EU Official Journal, L 39, 13.2.2008, pp.16-54.

Art. 296-306 of the Association Agreement are dedicated to geographical indications. The Government of Moldova after completing certain procedures shall protect geographical indications of the EU listed in Annex XXX-D of the Agreement. The EU similarly has to protect geographical indications of the Republic of Moldova. New indications to be protected can be added after the established procedure is satisfied.

Art. 299, in particular, presumes that protected geographical indications shall be protected against any direct or indirect commercial use of a protected name, any misuse, imitation of the true origin, any false indication of origin, nature or qualities, etc.

3.4 Opportunities and challenges

As it has been mentioned before, there exists a small number of protected geographical indications in the Republic of Moldova, because of the poor promotion and limited information about this system. However, this fact opens many opportunities for local producers, which can benefit from their "pioneer" status in this field, and register their specific traditional national product brand. There are well-known Moldovan products which have a potential to develop their presence in EU in the future and, thus, should be protected already today. Promotion and development of the GI's will contribute to better promotion and penetration of Moldovan goods into the EU market and will also bring considerable revenues as an instrument which will add value to the exported products.

3.5 Projection of future trends

Taking into consideration the poor development of the sector at present and the expected dissemination of EU practices in Moldova, the number of protected designations of origin and protected geographical indications registered in Moldova will in all likelihood increase, as well as the sales volume under this category of production, as happened in Bulgaria, for example, after this country became an EU member.[13] However, substantial promotion efforts are needed in order to achieve visible results.

3.6 Recommendations

In order to develop and promote the mechanism of protected geographical indications and designations of origin, the following measures may be relevant to be implemented by the authorities:

1. promotion and consultancy for producers in the field of intellectual property protection and the implementation of protected trademarks;
2. organisation of research work in order to identify new, potential GIs for wines and spirits, but mainly for other categories of products, such as cheeses, sausages, canned goods, etc.;
3. stronger collaboration between the State Agency on Intellectual Property of the Republic of Moldova (AGEPI) and associations of producers;
4. dissemination of information and assistance in the GIs registration;
5. stronger collaboration between AGEPI and appropriate EU institutions;
6. harmonisation of national legal framework with EU regulations, in particular, in terms of utilisation of the protected geographical indications according to EU norms;
7. promotion efforts and consultancy for producers in the field of intellectual property protection and, specifically, geographical indications.

[13] Value of production of agricultural products and foodstuffs, wines, aromatised wines and spirits protected by a geographical indication (GI), EC, 2012, http://ec.europa.eu/agriculture/external-studies/2012/value-gi/final-report_en.pdf

Entrepreneurs are recommended to:

1. establish collective organisations/associations of producers (to set up rules concerning the production, quality, packaging, controls, collective promotion, etc.);
2. investigate their own possibilities for registration of geographical indications in order to benefit in future from their use.

3.7 Useful links and addresses

1. State Agency on Intellectual Property of the Republic of Moldova (AGEPI), www.agepi.gov.md
2. EU basic regulation for protection of geographical indications for foodstuff, http://ec.europa.eu/agriculture/quality/schemes/index_en.htm
3. EU basic regulation for protection of geographical indications for wine sector, http://ec.europa.eu/agriculture/markets/wine/leg/index_en.htm
4. EU basic regulation for protection of geographical indications for spirits sector, http://europa.eu/legislation_summaries/consumers/product_labelling_and_packaging/l67006_en.htm
5. Moldovan legislation in the field http://agepi.gov.md/md/gi-ao-tsg/legislations.php

4. COMPETITION AND STATE AID

Competition and state aid policies are regulated by laws in the Republic of Moldova and the responsible authority is the Moldovan Competition Council, which was created in 2013. The most vulnerable sectors are insurance and banking, electrical energy distribution and production, postal services and telecommunications. Retail trade is the last in this rating.

The DCFTA underlines that anti-competitive business practices distort the proper functioning of markets, and, thus, Moldova, as well as the EU shall protect fair competition. The state aid that distorts competition is incompatible with the Association Agreement, with exception of products covered by the Agreement on Agriculture and fisheries. The Moldovan Government will have to administer biannually specific surveys on state aid and present it to the EU responsible bodies.

The Agreement also stipulates that each party shall maintain independent authority, which will be able to implement necessary policies. In this sense, development of the capacities of the Competition Council is becoming a crucial point for the implementation of the Agreement.

4.1 Brief description of the current situation

The Moldovan Competition Law no. 183 of 11.07.2013 establishes the normative framework of protection of competition and the liability for infringing on the legislation in the competition domain. The Law stipulates in Article 3.1 that the "State ensures the freedom of entrepreneurship, fair competition protection and defence of rights and interests of the undertakings and of the citizens contrary to the anticompetitive practices and unfair competition."[14]

The Law on State Aid (no. 139 of 15.06.2012) was adopted in 2012 and regulates the procedures for authorising, granting, monitoring, and reporting state aid provided to various entities of the national economy. The Moldovan Competition Council was created in 2013 in order to develop and implement competition rules in the country. Later, that Council developed the Information System "Moldova State Aid Register" (SIRASM) in order to collect and review the information on the state aid at the national and regional levels and to receive online notification, reporting and monitoring of state aid.

The state aid granted in Moldova accounts for around 8% of the government's budget expenditure and 3% of its Gross Domestic Product (excluding agriculture, fisheries and transport). The Government of Moldova directs state aid to support regional development, small and medium enterprises, research and development, services of general interest, and other policy objectives. While most of Moldova's state aid schemes are meant to target a broad number of beneficiaries, on average, 12% of aid administered from 2009-2011 was documented as aid to individual firms; much more individual aid was likely granted as unplanned or 'ad hoc' aid. In addition, around 90% of state aid is in the form of tax exemptions and subsidies – instruments that, when combined with lack of transparency, can be used to provide benefits to just a few firms. One of those medium-term objectives of the National Development Strategy for 2012–2020 and an important component of Moldova's efforts to comply with its commitments in the DCFTA relates to the policy commitment to reduce the market distortive impacts of its state aid.

The most visible example of Moldovan industrial policy with competition implications is the existence of Free Economic Zones (FEZ). According to Law no. 440 of 27.07.2001, FEZ are part of the customs territory of Moldova, but economically separate within a delimited area and where local and foreign investors receive preferential status for their business activities.

[14] http://competition.md/uploads/files/legi/concurenta/en/Competition%20Law%20nr.%20183%20from%2011.07.2012.pdf

The benefits of locating in FEZ include:

- government-protected investment;
- the legal status of the FEZ can be changed only by parliamentary legislation;
- ability to transfer profits abroad;
- preferential treatment aimed at stimulating economic activity;
- guaranteed legal provisions for ten years from registration as a FEZ resident;
- free movement of goods (services) within the FEZ;
- possibility of transmission of goods (services) from one FEZ resident to another, with only the bill of lading and no customs declaration;
- preferential customs treatment (customs post is located in the FEZ);
- tax advantages, including exemption from VAT on goods (services) delivered within the FEZ, exemption from excise duty on goods brought into the FEZ from outside Moldova, the other FEZ in Moldova, as well as goods originating in the region and exported from Moldova, exemption from excise on goods delivered within the FEZ and delivery of goods from one FEZ to another, etc.[15]

The World Banks's analysis[16] on determining the most vulnerable sectors from the competition point of view indicates the following priority domains for improvements:

- insurance and banks;
- electrical energy distribution and production;
- postal services and telecommunications;
- extractive industry;
- aero transportation;
- retail trade (the least problematic sector from the competition point of view);
- other sectors (see according to the link provided).

The National Plan for the Implementation of the EU-Moldova Association Agreement provides that general principles of state aid granting and competition should be compliant with the provisions of Law no. 139 of 15.06.2012 on State Aid and Competition Law no. 183 of 11.07.2012. The Competition Council, together with Central Public Administration Authorities, will review the legal framework on business regulation on compatibility with this document before the QIV of 2015.

4.2 Brief description of the EU market

The Council Regulation (EC) no. 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty stipulates basic rules and principles of competition protection in the EU.

In the last few years, Europe has undertaken a substantial amount of initiatives and reforms in the area of competition policy. Key policy reforms have been undertaken in the area of merger control and antitrust. In addition to these activities in the area of antitrust, the Commission has used Article 86 of the EC Treaty[17] to liberalise a number of network industries, such as Telecommunications, Energy, Transport, and Postal Services. Finally, the area of state aid control has undergone substantial reforms as well. State aid is a unique governance structure for Europe. There is no system like it in the world, where a group of countries has delegated as much power to a supranational institution to control the flow of state aid.

[15] Information from MIEPO web site

[16] http://competition.md/uploads/rapoarte_diverse/Analiza%20sectoarelor%20economice%20pentru%20%20a%20identifica%20obstacole%20majore%20privind%20concuren%C5%A3a.pdf

[17] http://ec.europa.eu/competition/legislation/treaties/ec/art86_en.html

The financial and economic crisis has increased the demand for state aid, not only in banking and finance, but also increasingly in all sectors of the economy. State aid has always been an area of competition policy where political pressures are significantly higher. Some experts consider that competition policy needs to be enforced – in particular in the area of state aid – so that markets continue to be open and transparent.

In 2005, Commissioner Kroes introduced the State Aid Action Plan (SAAP). The SAAP constitutes the blueprint for reform in the area of state aid. One of the main components of the SAAP was the so-called balancing test. The state aid balancing test is grounded in economic principles and allows for a meaningful assessment of the positive (correcting market failures or social objectives) and negative (avoid market distortions) implications of granting government aid.

In 2014, the European Commission finalised the State Aid Modernisation project which significantly updates the state aid control structure.

4.3 Reference to the Association Agreement/DCFTA

Chapter 10 of the DCFTA title of the Association Agreement refers to commitments on competition and state aid.

In particular, Art. 339 stipulates that state aid that distorts competition is incompatible with the Agreement, with exception of products covered by the Agreement on Agriculture and fisheries.

The Moldovan Government will have to administer biannually specific surveys on state aid and present it to the EU responsible bodies.

4.4 Opportunities and challenges

According to Article 107(1) of the Treaty on the Functioning of the European Union, a measure constitutes State aid if (i) an economic advantage is granted by a (ii) transfer of state resources (iii) favouring certain undertakings, and (iv) if the aid has a (potential) effect on competition and trade between Member States. Therefore, the EC usually ***considers tax incentives applicable in Free Zones to be State aid*** under Article 107(1) TFEU. Whilst this definition reduces the options for Free Zone operations, some exemptions may be granted under Article 107(3)(a) and (c) of the TFEU which allows for the use of State aid to tackle regional problems. All measures used for Free Zones which constitute State aid must be notified by the respective Member State for approval by the EC, unless they fall under the *de minimis* Regulation or the General Block Exemption Regulation.

For the Republic for Moldova this means a reduced capacity for change and the necessity to coordinate all policies and measures. Art. 310 of the Association Agreement stipulates that the obligation to respect European competition rules shall apply within five years from the date of entry into force of the Agreement; and this will be one of the most significant challenges for Moldova.

4.5 Information on the available financial and technical support

EC support program targeting competitiveness of small businesses and the promotion of export and investment opportunities (EUR 30 million).

4.6 Recommendations

Moldova has a long agenda of competition issues. The limited authority and power of the Competition Council coupled with systemic problems in judicial/court decision-making processes cause insufficient competition protection. Therefore, basic recommendations refer to:

1. review of competencies of the Competition Council and strengthening its capacities;
2. promotion of the competition culture in the business community;
3. elaboration and implementation of a national program in the competition field and state aid through adopting the best European practices;
4. elaboration of a study on the analysis of the competition environment in the strategic sectors of the economy and opportunities for improvements.

4.7 Useful links and addresses

1. Competition Council, www.competition.md
2. National Action Plan for the implementation of the RM-EU Association Agreement 2014-2016, Title V (approved by Government Decision on October 7 2014), http://www.mfa.gov.md/association-agreement-ro/
3. List of free economic zones in the EU, http://ec.europa.eu/taxation_customs/resources/documents/customs/procedural_aspects/imports/free_zones/list_freezones.pdf
4. Competition Law, http://lex.justice.md/eng/344792/
5. Moldovan Export and Import Promotion Organisation, www.miepo.md

5. LIGHT INDUSTRY

One fifth of Moldovan exports represent products of the light industry; however, many Moldovan producers still work on a "lohn" system. This mechanism permits survival in the short-term, but for a long and sustainable growth, the development of proper brands is vitally necessary.

The DCFTA underlines the importance of export promotion in Moldova and the necessity of modernising and restructuring certain industries. Light industry is among them.

According to the DCFTA, textile and clothing products originating from Moldova are exempted from EU customs duties. Only for several categories of products, the duty-free treatment is not granted automatically and will be progressively reduced, until fully eliminated, over a period of between 3 and 5 years.

The promotion and creation of proper brands is the biggest challenge for Moldovan producers in the years to come.

5.1 Brief description of the current situation

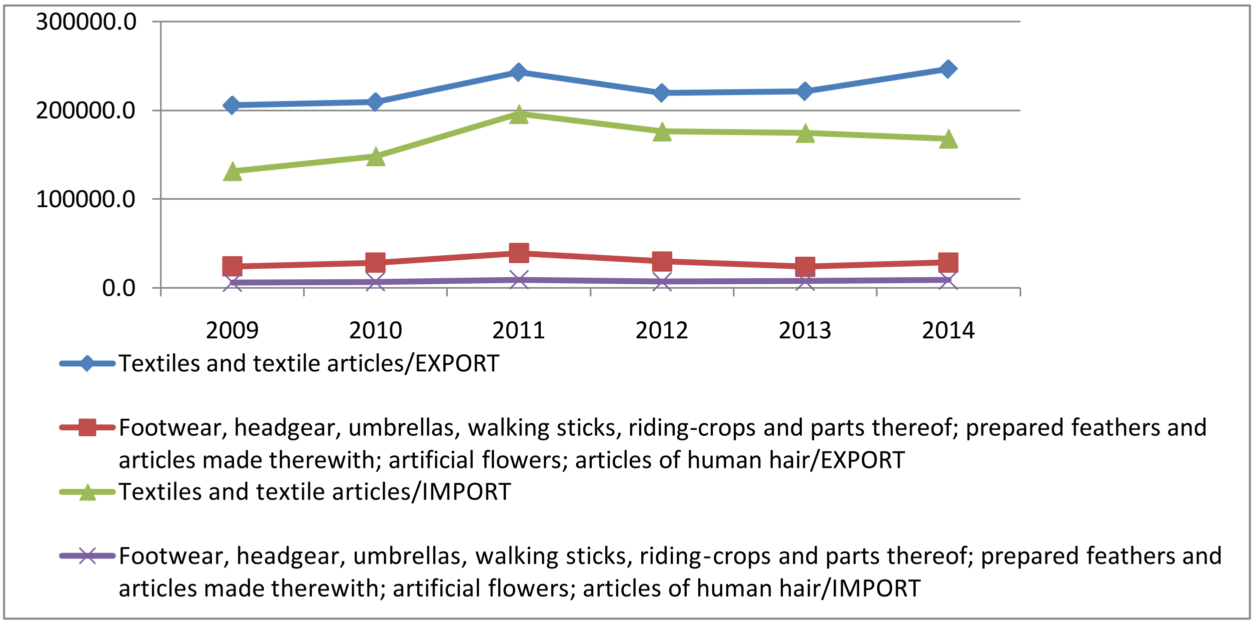
Light industry is an important part of the Moldovan economy. More than 20% of total exports are concentrated in light industry products. However, despite the fact that Moldovan light industry products are of very good quality, only 10% of them are sold in the local market, which, in turn, is predominantly saturated by cheap products from other countries (China) of questionable quality. The rest are exported to the UK, Italy, USA, Germany, Austria, the Netherlands and other EU countries. Many Moldovan producers are working for famous brands, such as United Colors of Benetton, Max Mara, Penny Black, Versace, Armani, etc. However, 90-95% of the entities are practicing the "lohn" system of production, i.e. manufacture from the raw materials, offered by the foreign partner. In 2010, the USAID CEED II program offered the opportunity to 12 local producers to develop their own clothing brands. In total, 15 brands were developed and promoted. Some of them became really successful, and are now able to sell their products in the EU under the proper brand name (e.g. Ravetti). The second stage of the program will include the development of the fashion industry, furniture production, household accessories, etc.

The "lohn" system, on the basis of which the majority of Moldovan light industry entities work, is very disadvantageous for them from many points of view, such as:

- it offers limited benefits to the producers, the biggest profits remain for those who order production, and therefore, capitalisation of businesses is very low;
- companies are not stimulated to promote their own brands and therefore stagnate, and, in a long-term perspective fail, as has happened to many Romanian producers at the end of the XXth century.

In terms of EU-Moldova trade statistics, exports and imports of the major categories of light industry products demonstrate the general situation – the value of exports exceeds the level of imports of light industry (Figure 7).

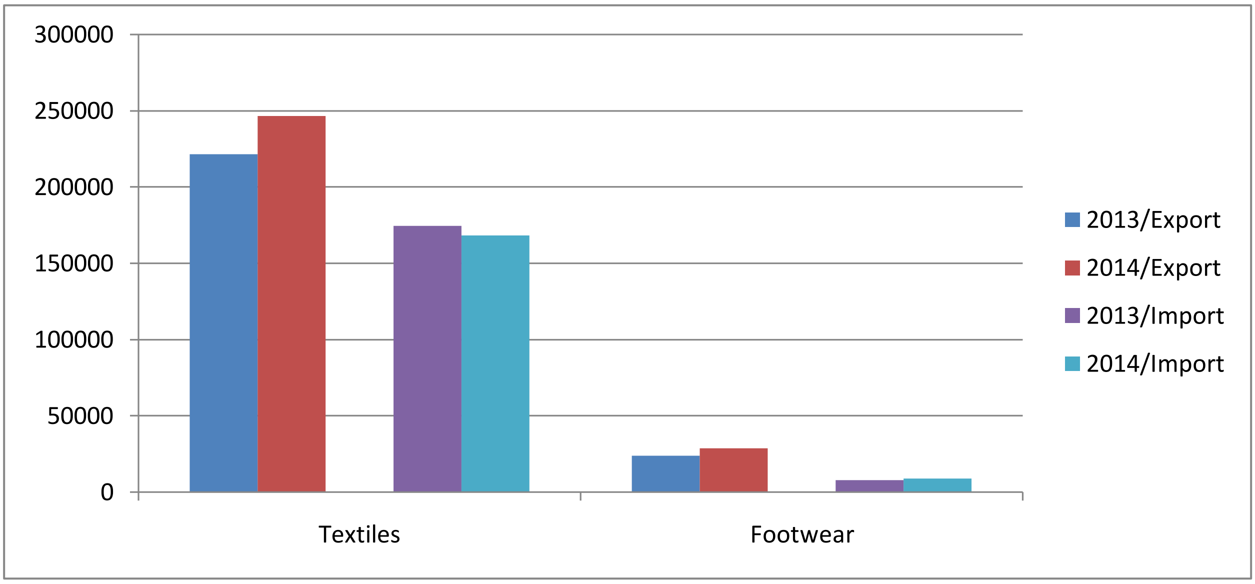
Figure 7. Imports and exports of the major categories of light industry products to/from Moldova and EU, 2009-2014, thousands USD



Source: data from the National Bureau of Statistics

Comparable data for 2013/2014 are presented in the Figure 8.

Figure 8. Exports and imports of the major categories of light industry products to/from EU in 2013 and 2014



Source: data from the National Bureau of Statistics

Exports and imports of textiles and footwear increased in 2014 in comparison to 2013 (with the exception of imports of textiles, which registered a slight decline).

Other selected data for 2013 in comparison to 2014 are presented below in Table 3.

Table 3. Exports and imports of some light industry products to/from Moldova and EU, comparative data for 2013-2014, QIII/2013-QIII/2014 and QIV/2013-QIV/2014

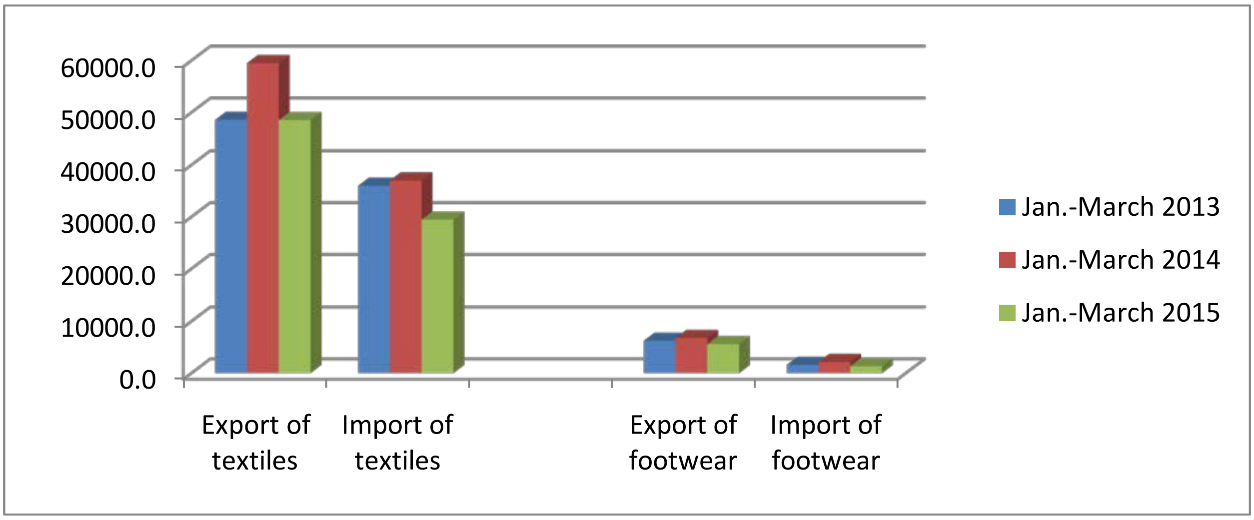
Products	2013	2014	QIII/2013	QIII/2014	QIV/2013	QIV/2014
Export:						
Carpets/m^2	363,486	633,955	102,887	125,844	125,451	211,866
Cotton fabrics/m^2	14,225,756	18,622,185	4131270	3,986,172	3,587,193	4,340,524
Import:						
Cotton threads		122,364	1,973	6,083	604	8,554

Source: data obtained from the Moldovan Customs Service

The implementation of the DCFTA had some immediately visible effects, despite the fact that some EU tariffs have already been eliminated under past trade regimes for Moldovan imports (notably under the Autonomous Trade Preferences). Moldova, in contrast, applies a gradual elimination of import duties, which will be eliminated in 3 years (for socks, pantyhose) or 5 years (for carpets and floor coverings, cotton clothing, etc.). Elimination of customs duties on imports, for perspective, must have a positive impact on Moldovan light industry development, as the cost of production will decrease and Moldovan products will become more competitive. Some experts estimate this decrease could be to the level of 4%.[18]

However 2015, in comparison with 2014, shows that both exports and imports of textiles and footwear decreased in Q1 2015 (Figure 9).

Figure 9. Exports and imports of textiles and footwear to/from the EU in January-March 2014 and in the same period of 2015, thousands USD

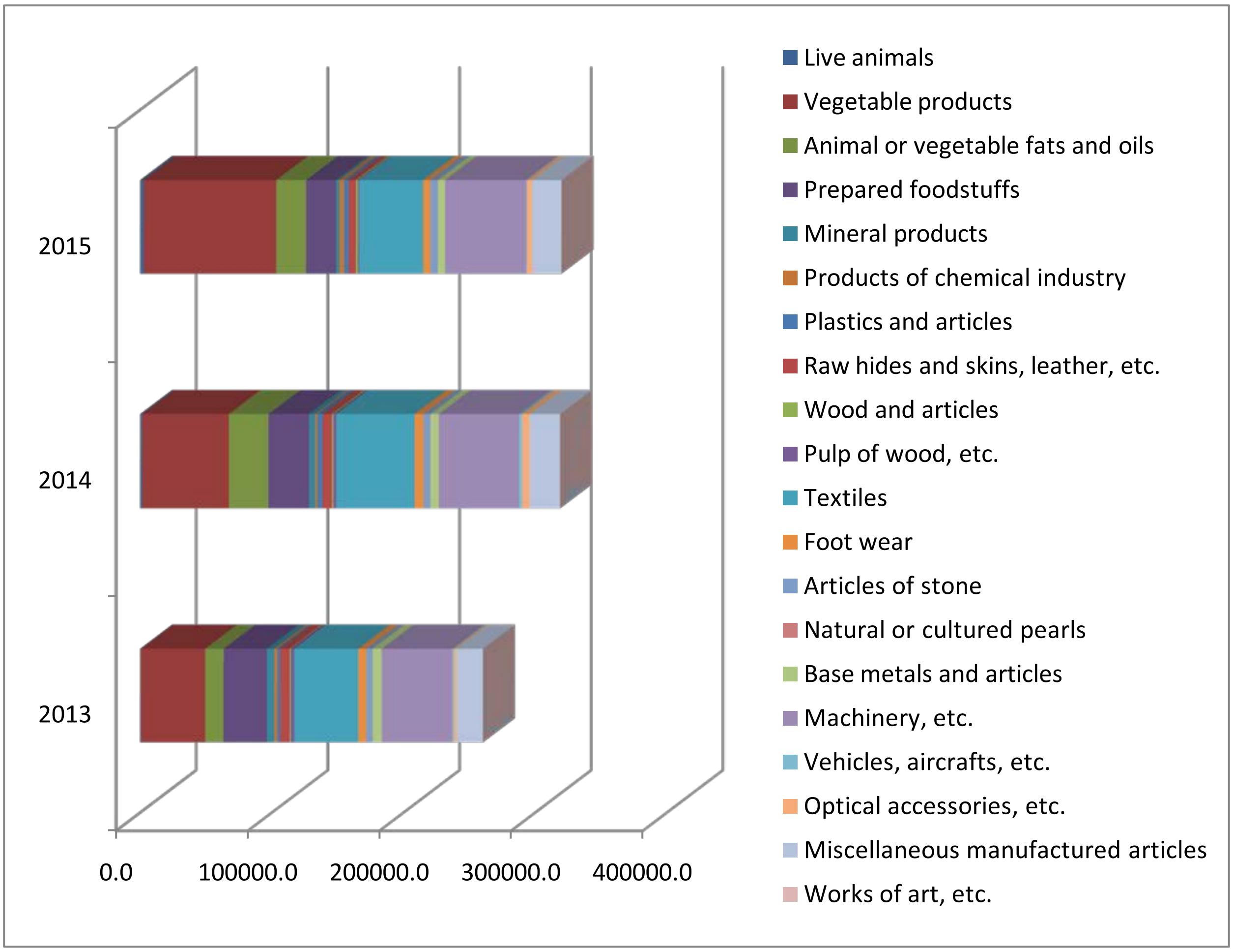


Source: data from the National Bureau of Statistics

A decline in both exports and imports of textiles and footwear can be observed in the first months of 2015 in comparison to the same period in 2014. Taking into consideration that total exports to the EU in the envisaged period have registered growth, the changes in export structure is marked (Figure 10).

[18] Alexandra Kan, interview for AGROBIZNES, http://agrobiznes.md/acordul-de-liber-schimb-cu-ue-va-permite-moldovei-sa-si-diversifice-exporturile.html

Figure 10. The structure of exports from EU to Moldova in January-March 2013, 2014, 2015



Source: data from the National Bureau of Statistics

Figure 10 shows that the structure of exports in the first three months of 2015, in comparison to the same period of 2014, changed slightly. Agricultural products, primarily vegetable products significantly increased their presence in the structure of exports, while goods from the light industry constituted a smaller part of the total export values. These changes may reflect the impact of the Russian embargo or a more general tendency, if maintained for a longer period.

5.2 Brief description of the EU market

The light industry in Europe and the textile and clothing sector especially, has been subject to a series of radical transformations over the decades, due to a combination of technological changes, the evolution of production costs, and the emergence of important international competitors.

In response to competitive challenges, the light industry in Europe has undertaken a lengthy process of restructuring and modernisation including the substantial shrinking of its workforce. Companies have improved their competitiveness by substantially reducing or ceasing mass production of basic textiles or clothing articles, and concentrated instead on a wider variety of products with a higher value-added. Moreover, European producers are world leaders in markets for technical/industrial textiles and nonwovens (for example: industrial filters, geo-textiles, hygiene products, or products for the automotive industry or the medical sector), as well as for high quality garments with a high design content.

Competitiveness has also been retained by sub-contracting, or the relocation of production facilities, for labour-intensive activities such as garment making, to companies or countries with lower labour costs. The competitive advantages of the light industry sector in the EU are founded on quality and design, creativity, innovation and technology, and high value-added products.

5.3 Reference to the Association Agreement/DCFTA

Chapter 10 of Title IV is dedicated to industrial and enterprise policy. It mentions the importance of export promotion in Moldova, and the modernisation and restructuring of certain industries.

According to the provisions of Articles 143-153, Title V of the Association Agreement and Annex XV of the Association Agreement, textile and clothing products originating from Moldova are exempted from customs duties.

- Import of textiles and clothing products to Moldova from the EU are not subject to import duties. However, for several categories of products, the duty-free treatment is not granted automatically. The duty is progressively reduced, until fully eliminated, over a period of between 3 and 5 years. The list of products to which a gradual elimination of duties applies, is included in Annex XV-D.

5.4 Opportunities and challenges

Taking into consideration the situation described in section 5.1, Moldova's light industry sector has a lot of opportunities and challenges to face in the future in order to become independent, i.e. work for proper brands and promote local producers, and sustainable, i.e. to look at the long-term perspective. The experience and knowledge gained while working under the "lohn" system have to be transformed into modern and competitive brands, known in the country and outside.

5.5 Projection of future trends

If the Moldovan light industry entities fully develop their potential, the elimination of customs duties under the DCFTA is likely to increase exports. In consequence, imports of raw materials for production from the EU will also increase. However, a deeper analysis of future trends may be needed in order to take into consideration a large range of factors, which can influence export growth.

5.6 Information on the available financial and technical support

There are several programmes, currently available for producers in the light industry in Moldova:

1. Program of Assistance for Industry and Infrastructure of the Government of Poland (EUR 100 million for preferential credits);
2. COSME program of the European Union (EUR 2.3 million available for grants/subventions);
3. State Program for Stimulation of Participation at Exhibitions;
4. PARE program 1+1 (86 million MDL);
5. Other programs (see www.finantare.gov.md).

5.7 Recommendations

1. Promotion of brands development and creation of new brands.
2. State programs to promote access of Moldovan brands to foreign markets.
3. Promotion of new products and brand names, which can be associated with tourism to Moldova.

5.8 Useful links and addresses

1. Financial support available, www.finantare.gov.md
2. Web site of famous Moldovan textile brands, www.dininima.md

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This publication was prepared with the assistance of:
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This publication is financed
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