

**ECONOMIC DYNAMICS OF THE REPUBLIC OF MOLDOVA
IN THE CONTEXT OF EUROPEAN INTEGRATION**

*Igor PRISAC¹, PhD, Lecturer,
„Divitia Gratiae” University*

This article provides an analysis of the economic evolution of the Republic of Moldova by defining three evolution and development periods in the regional and global context. Studying the perspectives of integration into the Commonwealth of Independent States (CIS) economy, on one hand, and European integration, on the other hand, is another objective of this chapter. The analysis of the investment climate, the business environment and the foreign trade has a major contribution to the perception of the economic dynamics of the Republic of Moldova.

Another research direction of this paper is the analysis of the economic reform efforts undertaken by the government and their impact on the economic system of the Republic of Moldova. The research methodology includes a classical approach, such as methods of comparative, historical-analytical, systemic analysis and quantitative and qualitative analysis.

Key words: liberalization, market economy, export, investment, reforms, European integration, periods, policies, entrepreneurship.

Prezentul articol cuprinde o analiză a evoluției economice a Republicii Moldova prin definirea a trei perioade de evoluție și dezvoltare în contextul regional și global. Studiarea perspectivelor de integrare la economia țărilor CSI, pe de o parte, și integrarea europeană la UE, pe de altă parte, este un alt obiectiv al acestui capitol. Analiza climatului investițional, mediului de afaceri, precum și comerțului extern are un aport major la perceperea dinamicii economice a Republicii Moldova.

O altă direcție de cercetare a prezentei lucrări o constituie analiza eforturilor de reformare economică din partea guvernării și efectele acestora asupra sistemului economic al Republicii Moldova. Metodologia de cercetare cuprinde abordarea clasică cum sunt metodele analizei comparative, istorico-analitică, sistemică, precum și analiza cantitativă și calitativă.

Cuvinte cheie: liberalizare, economia de piață, export, investiții, reforme, integrare europeană, perioade, strategii, politici, antreprenoriat.

В этой статье приводится анализ экономического развития страны через определение трех периодов эволюции и развития в региональном и глобальном контекстах. Изучение перспектив интеграции в экономику стран СНГ, с одной стороны, и европейской интеграции в ЕС, с другой стороны, это еще одна цель данной работы. Анализ инвестиционного климата, бизнес-среды и внешней торговли имеет значительный вклад в восприятие экономической динамики страны.

Другим направлением исследований данной работы является анализ экономических реформ правительства и их воздействия на экономическую систему Республики Молдова. Методология исследования включает в себя классический подход, то есть методы сравнительного анализа, историко-аналитический, систематический, количественный и качественный анализ.

Ключевые слова: либерализация, рыночная экономика, экспорт, инвестиции, реформы, европейская интеграция, стратегия, политики, предпринимательство.

JEL Classification: O11; F43; G15; G19

Introduction. With the exit of the Soviet Socialist Republic of Moldova (SSRM) from the USSR and the collapse of the totalitarian communist governing system, the Republic of Moldova has set a transformation path defined as transition to market economy. In order to achieve this major objective and to implement the transition programs, the Republic of Moldova has undergone many reforms in terms of legislation and economic structure, aimed at creating a free market, establishing private property,

¹ © Igor PRISAC, ida@uni-dg.md

modernization of agriculture, production activities, export promotion, and local and foreign investment attraction. With regards to international economic relations and integration into regional and global economy, the economic strategy was influenced by the Eastern and the Western foreign vectors, on one hand, and by the EU, on the other hand. In terms of national security and defense strategy, Moldova is determined in an equal extent by both, Euro Atlantic processes (represented by NATO and the USA), and by the Russian Federation. The weak economy and the dependence on energy resources and foreign market have reduced the neutrality status to non-existence and the social and economic performances are far from complying with the requirements of a developed state, which would bring welfare to the population, as it has happened in the Central Europe and the Baltic States.

Therefore, to achieve the economic objectives and to create an efficient and sustainable economy, on 28 November 2013, at the Summit in Vilnius, the Republic of Moldova took the final decision to sign the Association Agreement with the EU and to set the path toward European integration in order to increase the flow of foreign investment and to liberalize the exports to the EU market, the largest market in Europe and one of the largest in the world.

The economy of the Republic of Moldova has gone through several development periods as a result of the reforms on transition to market economy. They aimed to liberalize the economic activity, to privatize the public property, to attract local and foreign investments, to promote exports to several regional markets and also to connect through integration to the EU's economic community. This complex of economic policies and reforms were implemented with the aim to contribute to economic growth expressed in GDP per capita, which has suddenly stagnated after gaining independence 1991. Therefore, in line with government's priorities and strategies and the economic achievements, we can distinguish 3 major periods in the economic development of the Republic of Moldova in the global context:

1. *Period of economic liberalization and public property privatization* (1991-2000);
2. *Period of strategies on investment attraction and export promotion* (2000-2009);
3. *Period of EU association* (2010 – present).

Economic liberalization and public property privatization 1991-2000

Once confronted with the intensive transition to market economy at the beginning of '90s, the Republic of Moldova and its economic system were subject to a series of reforms in such areas as creation of democratic institutions, price and trade liberalization, public property privatization, adoption and amendment of legislation on entrepreneurship, private property, investments, capital market, foreign exchange market, etc. Becoming an independent state, the Republic of Moldova had a strong need to attract investments and to recover the markets lost in the former USSR republics, and also to win new markets globally. The first concrete steps in this direction were made with the adoption of several laws aimed at establishing the legal framework of reforms, such as: *the Law on property* (22 January 1991); *the Law on privatization* (4 July 1991); *the Law on entrepreneurship and enterprises* (3 January 1992); *the Law on domestic trade* (23 February 1996); *the Law on investment funds* (5 June 1997), *the Law on securities market* (18 November 1998) etc.

Most of the economic reform efforts undertaken by the government at that time have been consumed for the implementation of the privatization process. The privatization process in the Republic of Moldova had 3 major stages:

1. *State Privatization Program 1993-1994* that set the adequate legal basis and led to the creation of the Ministry of Privatization and State Property Administration;
2. *Privatization Program for the period 1995-1996*, that provides for the implementation of public property privatization based on *property coupons*, *free distribution* of agricultural farms and agricultural land, *privatization of dwellings*, etc.;
3. *Privatization Program for the period 1997-1998*, that envisaged the privatization of public property on cash basis [10, p. 9-10].

The privatization lasted almost a decade and involved several shortcomings, in particular, in the area of agricultural land privatization. In parallel with this process, the main institutions on the capital market have been created: Stock Exchange, investment funds and trust companies, independent registrars, broker and dealer companies. Therefore, in 1997 the private sector represented already 60% of the industrial production, 70% of retail services and social services provided, and respectively 44% of the volume of works in capital constructions and transport [10, p. 10]. The process of agricultural land privatization corresponded to the first stages of privatization, which led to a significant increase of surface areas allocated to rural families (from 180 thousand ha in 1990 to 300 thousand ha in 1992), and the

second – *the large privatization* has extended on agricultural land cultivated by former collective enterprises [11, p. 44]. In the period 1996-2000, more than three million of Title Certificates confirming Land holder's rights have been issued to over 1 million of citizens of Moldova [11].

Despite the fact that during these years we managed to establish a European legal framework and create democratic administrative bodies that would lead to economic liberalization and to a process of simplification and reduction of state restrictions and regulations to ensure a broad participation of the private sector in economy, these efforts have not proved to be efficient in stopping the economic decline in the '90s. The agriculture and the processing industry had a strong need to promote the products on the foreign markets and to attract investments for production modernization. Therefore, the privatization model that took place in the Republic of Moldova did not have the capacity to guarantee the entrepreneurship development, in particular among farmers holding Title Certificates on agricultural land with an area of several hectares.

In the '90s there were different considerations regarding the adoption and the implementation of reforms. Both, the international donors and experts, recognized the economic reforms as correct and considered them a perfect laboratory for reforms' implementation [2, p. 103]. However, analyzing the economic performance in the second half of the '90s, we can conclude that the economic transformation efforts have not been successful neither at the level of economic indicators, nor at social level. In 10 years of reforms, the country's GDP has reduced three fold, and in 2000 it represented only 34,3% of the total volume of the year 1990 [2, p. 102]. The foreign trade liberalization, which implies the cancellation or reduction of trade restrictions or barriers between two or several countries, even at the stage of economic initiation, caused the invasion of the foreign products on the Moldovan market and the local producers lost the traditional foreign markets and also lost the domestic market, which was rapidly occupied by the imported goods [2, p. 108-109].

Another factor that led to a significant drop in the GDP and capital investments in the first period of the economic dynamics of the Republic of Moldova was its integration in to a vulnerable regional market and namely CIS market, community founded by the former socialist republics, except for the Baltic States. In turn, these national economies were undergoing the same stage of economic restructuring or, in other words, were demonstrating the same shortcomings and economic imbalances as the Republic of Moldova and specifically: significant reduction of GDP and investments. At the beginning of the '90s, Moldova was strongly integrated with CIS countries (10 times more) compared to the European Economic Community, and the share of exports outside CIS countries was 1.6% and imports – 7.3%, even if commercial relations were maintained with over 60 countries [8, p. 3]. For a long period of time, the exports were directed mainly towards the Russian Federation, which represented approximately 60% of the total exports and respectively 83% of the exports to the CIS countries, while the exports of the Republic of Moldova to the CIS countries represented 70% [1]. A balance of the exports structure by countries was achieved only in 2005, when the share of exports to the CIS countries was approximately 50,5% [1].

Adoption of strategies on investment attraction and export promotion 2000-2009

Despite the fact that the GDP volume slightly increased in the period 1999-2002 compared to the previous years (Figure 1), the share of exports was still dependent on the CIS market, while the investments in the real economy were not sufficient to create decent jobs and respectively to contribute to the growth of the national income.

In the second period of Moldova's economic development, the state's economic policies were directed towards creation of a favorable business climate to attract investments, in particular indirect foreign investments, and to increase the export based on structural development by promoting the goods and the services on the global market and reducing the dependence on the CIS market. Therefore, one of the attempts to develop the policies in the area of investments and export promotion was the approval of *the Investment Strategy of the Republic of Moldova for the period 2000-2005* and the *Export Promotion Strategy for the period 2000-2005* [5, p. 4]. Most of actions set in the respective strategies have not been implemented for the following reasons:

- Focus on the idea of national economic development based on the economic structure inherited from the soviet system;
- Global imbalances and changes in the regional circumstances;

• Non-systemic approach of public authorities and the private sector demonstrated by insufficient level of coherence between the policies/actions for the development of trade regimes (exports promotion) and investment activities, etc. [5].

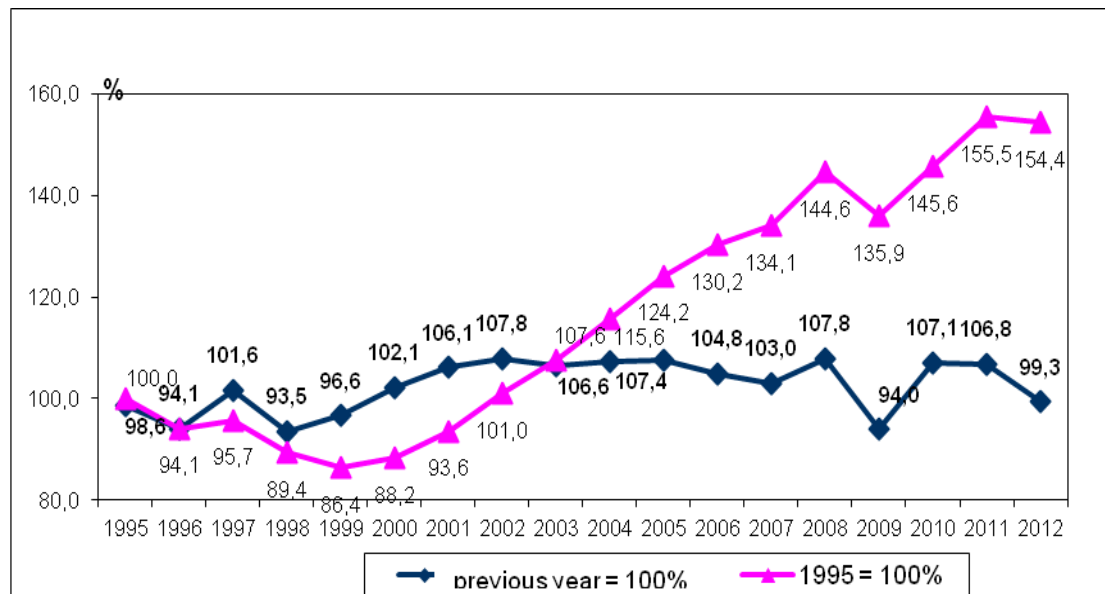


Fig. 1. Indices of the physical volume of gross domestic product in the period 1995-2012

Source: National Bureau of Statistics of the Republic of Moldova. National accounts: Gross domestic product indices (1995-2012). <http://www.statistica.md/category.php?l=ro&idc=191> (quoted 07.10.14).

This fact has determined the Government of the Republic of Moldova to adopt the *Strategy on investment attraction and export promotion for the period 2006-2015*, which is a long-term and integrated [5] strategy. According to this strategy, the combination of the investments attraction policy and the export promotion policy created a favorable pre-requisite for ensuring economic growth and population's welfare. One of the main objectives presented by the Government is to attract investments in national sectors oriented towards export, capable to provide innovations and *know-how* transfer, increase added value and create an efficient technical and economic infrastructure [5, p. 5].

Consequently, the Republic of Moldova joined the WTO on 26 July 2001, obtaining a liberalized access of trade with goods and services on the market of those 160 member states (as of 2014). As a result, the Republic of Moldova has achieved the cancellation of several constraints in promoting exports on the global market.

As mentioned above, in the first half of this period of Moldova's economic development, the export was predominantly oriented towards the CIS market and, in particular, the Russian market in terms of the goods with commercial advantage. As of 1994, the intention to sign the *Agreement on creation of a free trade zone* within the CIS persisted, which was only signed in 2011 by 8 CIS members. Certain provisions of this Agreement with respect to free trade were already stipulated in bilateral agreements, including with the Russian Federation [4, p. 5]. And even following the signing of this agreement, the representatives of several political powers and academia were skeptical with regards to the positive effects of such an agreement on the foreign trade of the Republic, due to several reasons. The experience of trade relations knows a number of embargoes imposed by the Russian Federation due to which the national economy has suffered. Beginning with 2006, there were several trade interdictions and embargoes imposed by the Russian Federation:

- Interdiction on wine import from the Republic of Moldova and Georgia on the Russian market due to sanitary reasons (2006);
- „gas war“ between the Russian Federation and Ukraine, which has also affected the energy security of the Republic of Moldova (2009);
- New embargo on the Moldovan wine (2013);
- Prohibition of fruits and vegetable imports from the Republic of Moldova (2014);
- Interdiction on processed meat import from the Republic of Moldova (2014) etc.

In 2009, the Russian Federation resumed the initiative to create a free trade zone in the CIS area as a result of the distancing of the Republic of Moldova, Ukraine, Azerbaijan and Georgia from the CIS market in the favor of the global market, namely the EU market, and also for the purpose of maintaining the influence in the region. The purpose of such an agreement was also to implement the initiative of the Russian Federation as to make a return action to the EU and, specifically, the Eurasian Economic Union. Even if this Eurasian integration on economic, military and security issues seems to advance, it still has a lot of weaknesses, one of which is the fact that the states associated with the union may withdraw from this agreement if this contravenes their national interests, and their market is characterized by several risks and is much smaller than the EU market. Therefore, after 2005 the foreign trade is gradually orienting towards third markets and the EU market (Figure 2). However, the CIS market is still an important trade partner for certain economic entities.

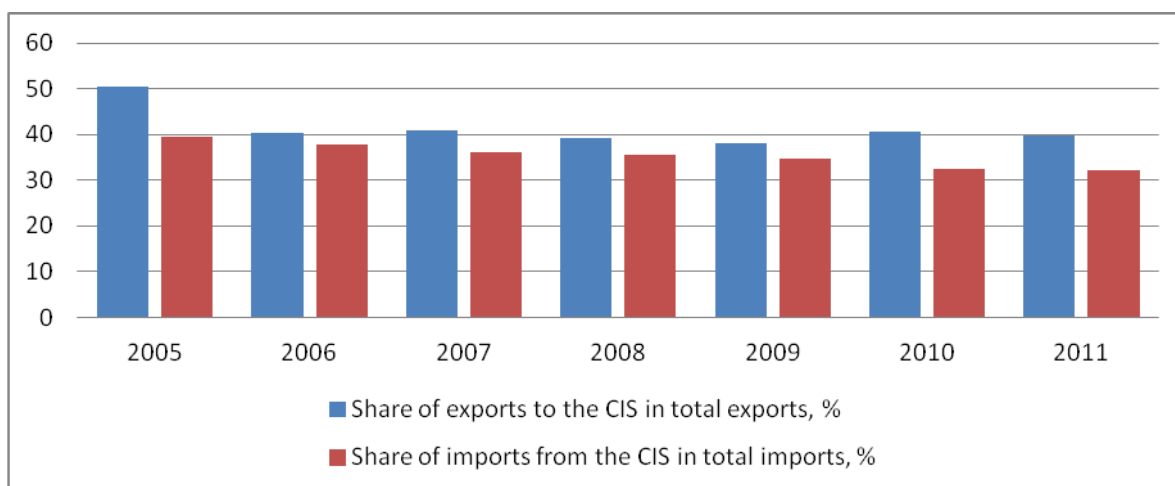


Fig. 2. Foreign trade with the CIS (2005 – 2011)

Source: Fala A. Policy Brief. *Poliocy Brief. Noul acord privind crearea zonei de liber schimb în CSI – posibile consecințe pentru Moldova. Chișinău: IDIS Viitorul, 2011. p. 8.*

Although the Government made significant efforts during this period to attract investments and promote exports, the results obtained were modest, and the negative trade balance for the year 2010 represented 2,43 billion USD, increasing by 318 million USD compared to the previous year [1].

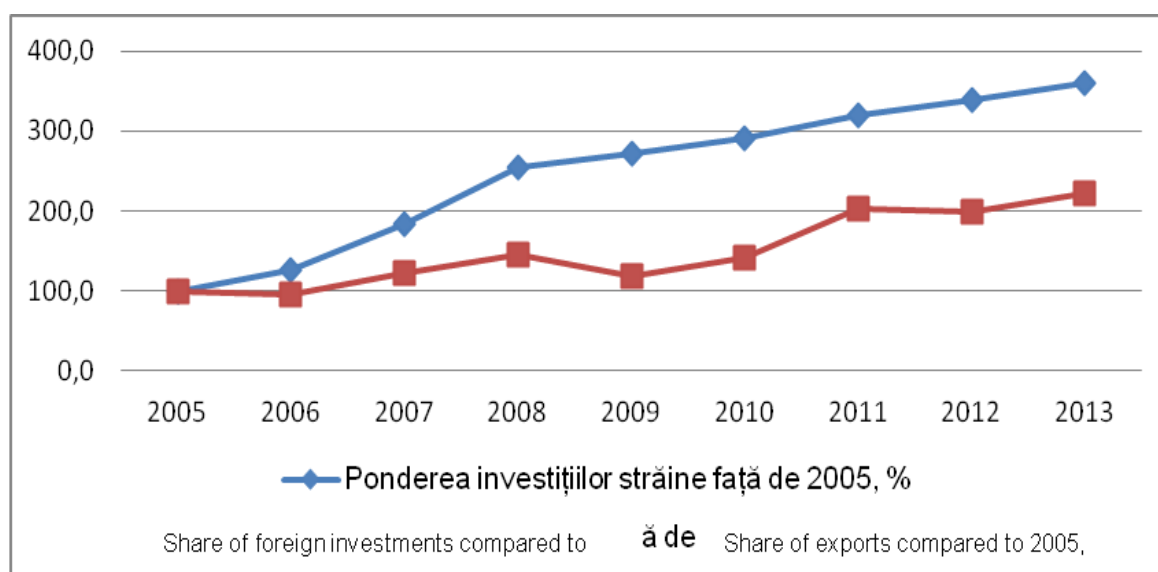


Fig. 3. Share of foreign investments and exports compared to 2005

Source: Created by the author based on National Bureau of Statistics of the Republic of Moldova. <http://www.statistica.md/category.php?l=ro&idc=191&#idc=34> (quoted 08.10.14).

Therefore, these modest performances were due to both, the financial crisis in 2008-2009 and the reduced results on investments attraction and export promotion, the inefficiency of institutions and the rule of law, corruption, etc. With the change of the geopolitical context at the beginning of the third decade following the creation of the republic and due to the firm decision of the political leadership on EU market association, an important review of the structure and strategy on foreign trade and attraction of foreign investments takes place.

EU association (2010-present). The demonstrated inefficiency of integration into the CIS area over 20 years and the economic results achieved by the EU member states from the Central and Eastern Europe, the Republic of Moldova adopts and gets intensively involved in the process of EU association, with the resolution of the deep political crisis between September 2009 – March 2012 (the longest in the history of democratic states). The EU market and its production volume is one of the biggest in the world, which has determined most of the previous governments to make attempts of associating with this economic community, but without any significant progress. At this stage, the exports begin to be redirected towards the EU market and other markets as China and USA.

With the change of the foreign policy vector and the EU enlargement in 2004, the EU initiates in the same year the first important steps towards Moldova's adherence to the European community by including it in the EU's European Neighborhood Policy (ENP). The new level of collaboration focused on the intensification of the political dialogue between the Republic of Moldova and the EU [6, p. 9-10]. As part of this process, concrete measures were taken towards country's European integration, one of which was the signing, one year later, of the RM-EU Action Plan, which envisaged the implementation of reforms in the following 3 years in several areas such as democratic institutions, respect for freedom of press and expression, strengthening of the administrative and judicial systems, poverty reduction, economic growth, foreign trade with EU, etc. [9].

In the period 2007-2008, the Republic of Moldova benefitted from a larger opening of the European Union market, the facilitation of the visa regime with the inauguration of the EU Visa Common Application Center, the initiation of the adherence to the Energy Treaty Community, increasing assistance by 2013, signing of the investment agreements with the European Investment Bank and the European Bank for Reconstruction and Development [6, p. 10]. As a result of some progress in the reform process, the EU Council adopted in 2008 several conclusions on the application of the RM-EU Action Plan, emphasizing the support for the gradual approximation of the Republic of Moldova to the EU by initiating the negotiation of a new RM-EU agreement.

To go beyond the ENP and send its neighbors a political message of solidarity, in December 2008 the European Commission submitted the proposal to create the Eastern Partnership (EP) – a specific dimension of the ENP aimed at maintaining relations with the Eastern neighbors – Armenia, Azerbaijan, Belarus, Georgia, the Republic of Moldova and Ukraine. In May 2009, the Eastern Partnership was launched in Prague to implement a political association and economic integration between the EU and its Eastern partners, which would require new association agreements, including deep and comprehensive free trade areas and progressive integration into the EU [3] economy. This process involves also the facilitation of travel to EU through gradual visa liberalization, accompanied by measures to combat illegal migration [3]. Among all Eastern European states participating in the Eastern partnership, the Republic of Moldova managed to advance most of all in terms of objectives of this integration program. Following the initialing of the RM – EU Association Agreement at the summit in Vilnius on 28 November 2013, which includes also the creation of the Deep and Comprehensive Free Trade Area (DCFTA), and its signing on 27 June 2014, the Republic of Moldova enters a new integration phase. This agreement replaces the Partnership and Cooperation Agreement (PCA) and gives the perspective for modernizing its trade relations and its economic development by excluding the customs duties and fees and through comprehensive harmonization of the law, national norms and regulations with the European legislation on trade related sectors [7]. At the same time, on 28 April 2014 the citizens of this country obtained the possibility to travel visa-free to 26 countries of the Schengen Area.

After 2005 more and more economic entities were able to get to the EU market with their goods and services and the share of exports to EU exceeded 50% of their total (Figure 4).

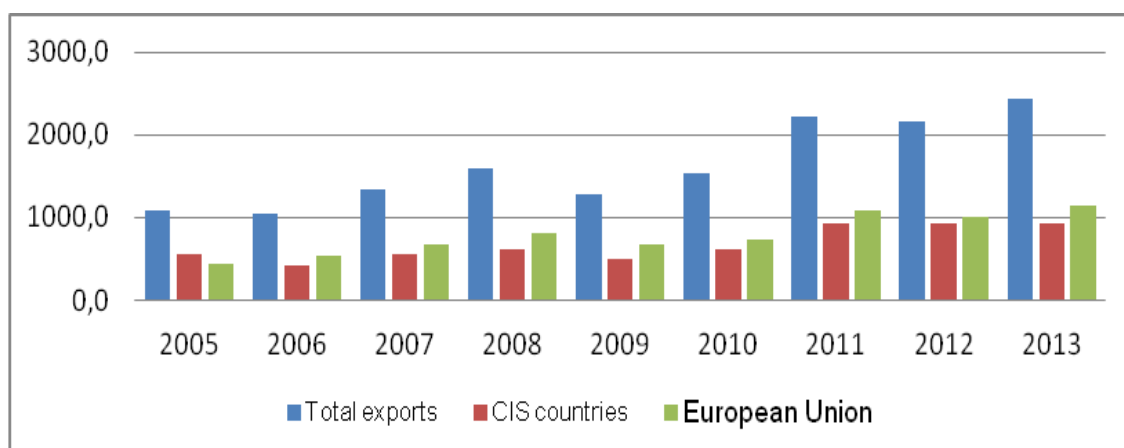


Fig. 4. Export structure of CIS and EU, USD (2005-2013)

Source: Created by the author based on National Bureau of Statistics. Foreign trade. <http://www.statistica.md/category.php?l=ro&idc=336&>. (quoted 10.10.14).

Conclusions. The benefits resulting from the products marketing on the EU market include also the compliance of products with the European quality standards, mobilization of successful entrepreneurship, and increased competitiveness of both, internal and external markets. Another long-term advantage of the European integration through gradual association consists in attracting direct foreign investments. However, at the current stage, the indicators on foreign investments entry to Moldova are below the expectations of the economic entities and the Government. Therefore, the country is in the process of accession to the EU as a member state and, according to expectations, this objective will reach the highest level of integration, namely the political, administrative and economic, which will significantly contribute to the attraction of foreign investments and free circulation of goods, services, work force, capital, technologies, etc.

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Recommended for publication: 25.03.2015