

Moldova as a neighbor of an expanding EU: economic growth, development and challenges

ALEXANDRU STRATAN
State University of Moldova
 Chisinau
 Republic of Moldova
 alex_stratan@yahoo.com

Abstract

The paper considers the future position of the Republic of Moldova as an EU neighbor depending mostly on the economic policy pursued today. It seems that the protracted stay of Moldova within a so-called “grey zone”, area of geopolitical uncertainty, comes to the end. Now, after Brussels launched the “Wider Europe” concept, the Government declared the idea of Europeanization to be an official priority and recent polls ascertained that 70% of the Moldovans favored EU integration. Since Moldova is not a real candidate for the EU membership in the mid-term perspective, there is enough time for adaptation of its economy to the European criteria as an “EU neighbor”. Basically, Moldova should accelerate reforms regardless of the fact whether Moldova will be an EU member or not.

This requires normalizing relations between the state and the economy, maintaining macroeconomic stability, improving business competitiveness, activating employment and human resources development. The paper demonstrates as well that a progressive economic development of the Republic of Moldova represents the basis for the improvement of economic environment and consolidation of the relations with the EU. Promotion of structural economic reforms is a way to modernize the Republic of Moldova, to lessen and gradually eliminate gaps between developed European states and to create a functional and transparent market economy compatible with the EU principles, norms, mechanisms, institutions and policies.

Speaking of Moldova’s European vector, one should consider both “pros” and “cons” of such orientation. Indeed, it could be already a near future when Moldova as a new neighbor of the EU will be able to count on raising financial and technical assistance, facilitation of visa regime, access to new markets. At the same time, given the Moldova’s unavailability, some of these advantages may turn into problems.

Reasoning from that, the Government and the business community must concentrate on improving the functioning of the economy: Normalizing relations between the state and economy, improving the business environment, developing the legal and institutional market infrastructure and eliminating the non-market mechanisms of market regulation; Converging the existing and future Moldovan economic legislation with the EU’s legislation (acquis communautaire);

Maintaining macroeconomic stability, lowering the inflation rate, creating incentives to save and invest; Implementing restructuring programmes, allocating resources to the most efficient sectors of the industry, increasing productivity and the competitiveness of products which will take into consideration the timetable for liberalization of the trade between Moldova and the EU; Structural transformation of agriculture and rural development; Intensifying state and private sector participation in the development of the infrastructure Improving the allocative role of the labor market, supporting the development of human resources; Consumer protection; Ensuring a well-balanced socio-economic development of the country’s regions; Thorough information of the society on the neighborhood process.

Another important aspect is attracting foreign investments into the country. And this requires urgent improvement of the country’s investment climate, as after the EU enlargement our neighbors – the new EU members – become main recipients of European subsidies and technical assistance programs.

Key words: economic growth, gross domestic product, integration, foreign investment.

JEL Classification: O11

1 Introduction

European choice is a strong incentive for Moldova, since it is this choice that provides the country with both democracy and institution-building, internal stability and external security. Moldova today is a partitioned state located at the periphery of the uniting Europe. When the EU expanded to the east after 2007, the Republic of Moldova, including Transnistria, bordered upon the region that professed principles of stability and security, prevention and elimination of conflict situations. Reunion of the country will open new possibilities before Moldova: strengthening its statehood based on international norms and rules; ensuring economic growth in view of improving the country's image and activating foreign trade, investments inflow and restructuring of the external debt; enhancement of the population's living conditions and poverty reduction.

The future position of the Republic of Moldova as an EU neighbor will depend mostly on the economic policy pursued today. On the whole, the nature and direction of reforms initiated in 90's – given all their inconsistency and contradictoriness – transformed a centrally planned economy into a market one.

At one time Moldova even enjoyed a reputation as one of the leading reformers in the region. By the mid-90's Moldova's policy-makers had successfully tackled a number of first-generation reforms, such as freeing up the vast majority of prices and liberalising domestic trade. Similarly, responsible monetary policies had brought a relatively quick end to the hyperinflation experienced in the early 90's, while liberalised trade policies permitted Moldova to become one of the first CIS countries to join the WTO. In terms of privatisation, a mass voucher scheme relatively quickly sold off the state-run small and medium enterprise sector. As a result, Moldova's private sector now accounts for 90% of official GDP, dominating not only the nascent services sector but also agriculture, following the break-up of collective farms in the late 90's, and industry, following the post-privatisation restructuring of two-thirds of the country's manufacturing enterprises.

Over a short period of time economy of the Republic of Moldova firstly went through a sharp downfall (by 2/3 as regards GDP), later endured a stable depression (aggravated by consequences of the Russian financial crisis of 1998) and, finally, during the last eight years, experienced renewal of economic growth, increasing internal consumption and incomes of the population [1].

Moldova's economy and its trade, earlier fully oriented to the East, have started to turn gradually to Europe. Thus, in 2008 more than 1/3 of Moldova's export fell on EU and CEE countries. To a certain degree, this was facilitated by realization of the Partnership and Cooperation Agreement between the EU and Moldova (since 1998) and since March 1, 2008 by the Autonomous Trade Preferences. Priorities realized now by both parties are as follows: investment promotion, customs and cross-border cooperation, justice, home affairs and legal approximation.

2 Body of Paper

The problem is that over the last years Moldova stayed within a so called "grey zone" – zone of geopolitical uncertainty. But even in this situation the country has already received about 300 mil euro of aid from the EU within the framework of the European Commission, TACIS and

other programs. These funds were meant for macroeconomic support, stimulation of private sector and export, as well as for reformation of administrative and judiciary systems [2].

One could assess work of the Government, Ministry of Finance and National Bank as successful based on the fact that they managed to maintain macroeconomic stability, there were positive changes in industry, constructions and services, incomes of the population increased, but the Government's activity along the reformation path has been mostly based on the "one step forward – two steps back" principle, which was the cause IMF and World Bank were so evidently disappointed saying that Moldova's liberal-market economic course is being transformed into state dirigisme.

It would be proper, though, at the same time to mention the risk factors as well that in 2008 intensified, rather than subside. Among them are:

- *Quality, structure of the GDP growth.* Share of real sector is rather small within the 2008 GDP growth. Its largest part is being formed in services and by net taxes on goods and import. GDP growth given such its structure is not equivalent increase of real resources at all;
- *Unsatisfactory state of business environment,* which shows through insufficient volume and structure of export, uncertainty of foreign investors' disposition, freezing of privatization and preservation of a vast shadow economy sector;
- *Critical state of the country's balance of payment* due to almost triple exceeding of import over export, while after relations with IMF and World Bank had cooled off possibilities of receipt of currency through external loans and investments have sharply dropped. Of a little help is replenishment of the country with money transfers of our citizens working abroad – circa 1,9 bil. USD in 2008;
- *Inflation leap* up to 10% in 2008 (4.4% in 2002) and 20.0% increase in prices for foodstuff. Approximate 1/3 increase of wages and pensions also left its traces, even though wage arrears reached 13,3 mil USD. Danger emerges of a critical gap between the need to expand monetary aggregates and capacities of the inflation-free emission;
- *Further increase of external* (1,4 bil USD) debt;
- *Unreformed state machinery,* which is the cause many "2003 initiatives" either were not realized, or yielded small or negative results. Among them are: implementation of the strategy of economic growth and poverty reduction, development of a competitive environment and small and medium business support, activization of export and foreign investments attraction, administrative-territorial reform, fight against economic crimes and corruption, rapprochement with Transnistria.

Unfortunately, 2008 was another pre-election year and, of course, there were a lot of PR-economy, Government's promises and counter-critics of the opposition. Nonetheless, one could insist that the country's economy had already adapted to market conditions and therefore growth inertia has already emerged, and given all risk factors no one should expect any force majeure events during 2008. There were encouraging signs that, economic policy would finally become intelligent and we would get a "year of active actions", but the world crisis showed up and made its influence.

Reasoning from that, the Government and the business community must concentrate on improving the functioning of the economy:

- *Normalizing relations between the state and economy, improving the business environment, developing the legal and institutional market infrastructure* and eliminating the non-market mechanisms of market regulation;

- *Converging the existing and future Moldovan economic legislation with the EU's legislation (acquis communautaire)*; the objective is to create a coherent set of rules facilitating the development of trade between Moldova and the EU. From the point of view of the economy, the most important are the norms regulating the financial situation and functioning of economic entities, and the norms regulating economic relations;
- *Maintaining macroeconomic stability*, lowering the inflation rate, *creating incentives to save and invest*, ensuring stability of public finances through limiting the scale of deficits and the public sectors debt and *carrying out of reforms of the social security system* and the financing of the health care system, while of the same time striving towards limiting taxation and the role of the state in the redistribution of incomes;
- *Implementing restructuring programmes, allocating resources to the most efficient sectors of the industry, increasing productivity and the competitiveness* of products which will take into consideration the timetable for liberalization of the trade between Moldova and the EU. Industrial policy of the Government must be based on the assumption that the key to success of Moldovan enterprises in the Union market will be the role of management and their market strategies, as well as the ability to achieve fast increases of productivity through investing in both human and material resources;
- *Structural transformation of agriculture and rural development* will be related to the implementation of two parallel processes: modernization of agriculture aimed at improving the agricultural and socio-professional structure and increasing the competitiveness of Moldova's agriculture; and diversified development of rural areas allowing permanent or temporary outflow of agricultural workers to non-agricultural jobs and support for alternative sources of income accompanied by development of the technical and social infrastructure of rural areas;
- *Intensifying state and private sector participation in the development of the infrastructure* (electric power sector, gas system, telecommunications, transport, water supply) through their financing from budget resources and creating incentives for participation of foreign investors;
- *Improving the allocative role of the labor market, supporting the development of human resources* and in particular providing the necessary funds for the development of science and improvements in the quality of education;
- *Consumer protection*: adaptation of Moldova's legislation and business practice to the requirements of the EU, creating a product safety monitoring system;
- *Ensuring a well-balanced socio-economic development of the country's regions* based on stimulation of development of *towns – growth poles*, efficient utilization of local labor, financial and natural resources, capacities formed by the "Upper Prut" and "Lower Danube" *Euro-regions, cross-border cooperation*, as well as *investment projects* implemented within the framework of the Pact for Stability in the South-Eastern Europe;
- *Thorough information of the society on the neighborhood process* being carried out by the Government's promotion activities and non-governmental institutions. The overall positive attitude of Moldovans towards the EU, nonetheless, contains many myths, anxieties and hopes. Therefore, a vigorous information campaign aimed at presenting all the benefits and costs of the neighborhood with the EU to prepare the country's population for the life when Moldova's geo-political situation after 2007 is dramatically changing.

The Government is convinced that there are no fundamental contradictions between the pro-CIS and pro-EU policies. The European Commission's opinion is apparently different declaring that in the mid-term perspective Moldova has no chances of becoming an EU member.

The EU Board will start a new action plan for Moldova. And further everything will depend on political will and consistency of actions of the Moldovan party.

Proposing ever new initiatives along the European direction (as also regards settlement of the Transnistrian conflict) we should not slacken efforts to realize political and economic clauses of the EU-Moldova action plan. The action plan potential is far from being fully realized. What can it give to Moldova as regards approaching Europe? This includes:

- creation of joint bodies (including the higher level) to examine all problems related to partnership and cooperation between the RM and EU;
- formation of the “functioning” legal environment through approximation of Moldovan legislation to the EU one;
- accustoming to universally recognized rules of international trade;
- gradual transition to normal conditions of competition, which in the end should raise the economy’s efficiency;
- financial assistance of the EU in developing key sectors of our country, which helps implement economic and social reforms.

3 Conclusion

Now, the most realistic for Moldova is its participation in processes of sectoral integration with the EU. This means ensuring Moldova with autonomous trade preferences followed by the Free Trade Agreement, infrastructure development, border control, etc. One of the priority directions of the PCA implementation is creation of a free trade zone between Moldova and EU. It is important to mention that since the present Moldova still cannot assume obligations to create a zone of free trade with the EU (due to underdeveloped competitive environment and administrative capacities), the EU is willing to consider new possibilities of providing Moldovan goods access to the market within the framework stipulated by the WTO.

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Thus, for instance, transition of the united Europe to common norms and standards will undoubtedly facilitate movement of goods throughout its market. With this in mind, Moldova should provide “euro-harmonization” of its standards and requirements and the conformity assessment procedures. Sluggishness will sharply worsen the access of Moldovan products to European markets, especially as regards foodstuffs.

Another important aspect is attracting foreign investments into the country. And this requires urgent improvement of the country’s investment climate; otherwise after the EU enlargement the new EU members became main recipients of European subsidies and technical assistance programs. It is not excluded it will be the new members’ economies that EU will encourage investments into, leaving the “tardy” Moldova outside this activity.

Process of Moldova’s approaching Europe requires a lot of efforts and time. Therefore it is not rare when a question arises: is EU membership an absolute necessity for Moldova? To answer this question, a more detailed analysis of the impact of EU policies (Common Agricultural Policy, Social and Labor Market policies, Standard and Costs in Environmental Protection, etc.) on our national interests is necessary.

Enthusiasm of all branches of power is now focused at the European integration. But this enthusiasm also requires a wider public support. It is still unstable. According to opinion polls, population favors EU and CIS almost equally. Taking this into account, the two-level EU policy concerning Moldova is important – at the level of the Government and the civil society. This will be the case when in our country notion of “integration” will link closer to such notions as “democracy” and “development”.

Ultimately, all of us need democratically stable Moldova, integral from the political, social and territorial points of view. And its approach to Europe will undoubtedly enhance external positive impact upon the quality of governance, business and living in our country.

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