

Transnistria and the Deep and Comprehensive Free Trade Agreement: a little stone that overturns a great wain?

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■ Introduction

This document analyses the impact of the future Deep and Comprehensive Free Trade Agreement (DCFTA) between the Republic of Moldova and European Union, on the Transnistrian region and on the relation between Chisinau and Tiraspol regarding DCFTA implementation. The negotiations between Moldovan Government and European Commission regarding DCFTA are at a fairly advanced stage, expected by Moldovan side to be finalized in the first half of 2013. Chisinau has invited Tiraspol to participate in these negotiations; however, regional administration was reluctant, its presence being rather formal, with no practical implication on the trading positions formulated during negotiations by Chisinau.

The analysis begins with highlighting the major legal, geopolitical and economic implications of DCFTA and with analyzing the way Transnistrian region is covered by DCFTA.

In order to understand the possible ways Transnistrian region could be influenced by the upcoming DCFTA, the nature and magnitude of the trade between Transnistria with European Union and with the Republic of Moldova will be analyzed.

By exploring the scarce statistical data about the region's trade and economy structure, this analysis points out the most important implications that DCFTA could have on the Transnistrian economy.

Additionally, we provide a review of the most binding economic risks which Transnistrian region currently confronts with and which could amplify in the near future, especially if the region does not accept to reconcile the relations with Chisinau and to accept DCFTA provisions.

The study concludes by identifying and evaluating the options available to the Republic of Moldova and European Union in case of the highly possible situation of Transnistrian administration refusing, at least at the initial stage, to implement DCFTA in the territory controlled by them.

■ Deep and Comprehensive Free Trade Agreement: Major Implications

As part of Association Agreement, which could be signed by the Republic of Moldova and EU in 2013-2014, DCFTA has a number of major implications on the "high-level" policies. These implications target Transnistrian region too.

First of all, DCFTA would change the *legal fundamentals* of the trade relations between the Republic of Moldova and European Union. Until now, the Republic of Moldova benefited of trade concessions which were unilaterally granted by the European Union, either due to its obligations with respect to the World Trade Organization (GSP, GSP+) or in order to stimulate economic and political reforms in the Republic of Moldova (Autonomous Trade Preferences, which are still valid). However, the Autonomous Trade Preferences will be cancelled as soon as DCFTA is implemented. DCFTA will be based on an internal, bilateral document, with imperative legal power, with clear rights and obligations for both parties. This modification of the legal status of trade relations with EU involves, for the Republic of Moldova, both benefits, as well as risks. An important benefit from the legal point of view is that European Union will no longer be able to withdraw the trade concessions implying non trade-related causes, for example, related to obedience of labor or human rights. The risk is derived from the fact that, currently, Chisinau cannot guarantee an efficient, universal and uniform implementation of the Agreement on the Transnistrian region territory, which it does not control. This implies that the unconstitutional

authorities of the Transnistrian region, where currently companies do benefit of the Autonomous Trade Preferences, could be tempted to continue benefiting of the preferences related to export to EU markets, but will not mandatory admit preferential conditions for the import from EU countries into the region. (Or, this could be admitted only if the region would be implicitly recognized as a sovereign actor). Moreover, due to the fact that there is no control over the region, Republic of Moldova could face problems regarding the rules of origin for the exports of Transnistrian companies, even if those are registered in Chisinau. Alternatively, customs authorities need physical access to the deposits and production sites in order to issue certificates of origin. Currently, even though custom officers of the Republic of Moldova do have access (as far as we are know, with no right to wear uniforms or posses arms) to some of the companies in the region, the access is granted at the discretion of regional authorities. This will lead to the fact that the region will be regarded with suspicion by European customs authorities, which, from legal point of view, do not wish to import goods produced in third countries, under Moldovan trademark.

The second major implication is of **economic nature**. By undertaking “deep” and “comprehensive” responsibilities, Republic of Moldova will have to gradually adopt commercial and corporative standards, which will significantly limit the degree of politicians’ discretion and will impose a egalitarian principle when it comes to treatment of Moldovan companies with respect to the European ones (including from the point of view of competition, state aid, intellectual property rights, participation in public acquisitions). The economic forces activated by DCFTA will lead to capital and workforce reallocation from inefficient economic activities to the more efficient ones. Some economic branches and companies will no longer be capable of bearing the competition with producers from EU and Turkey and will close their businesses. The conditions according to which state aid is granted will have to be made transparent, while companies will have to work according to some authentic market economy norms. In other words, due to its “deep” and “comprehensive” components, DCFTA will create a new coordination system for the Moldovan companies to work in. These new rules will be, to a great extent, constructed based on a European model, which Moldova is oriented to transit to. However, these new rules might not be accepted by the self-proclaimed Transnistrian authorities who, in the past few years, have built a different economic system, based on special approaches and traditions. Practically, all standards, technical norms and statistical classifications are borrowed from the Commonwealth of Independent States and, especially, from Russian Federation. Another important element, in the Transnistrian region, is that state aid is granted in far from transparent conditions, while the political system is strongly interconnected with the economic one. Difficult challenges and dilemmas arise for EU when it comes also to the indirect aid given by the Russian Federation to Transnistrian companies through subsidized prices for natural gas.

Finally, DCFTA will also have a **strong geopolitical impact**. Creation of a free trade zone with EU, as part of Association Agreement, will formalize the relation between EU and the Republic of Moldova to a higher ranking as compared to the current relation between the Republic of Moldova and Russian Federation. It is no secret that one of the major goals of the Russian Federation with respect to the Republic of Moldova is to permanently include our country into its zone of influence and to impede the development of relationship with EU – in particular, and with the western countries and structures – in general. The deliberate maintaining of the Transnistrian conflict in a latent phase was one of the instruments used by the Russian Federation to ensure the accomplishment of this interest. Implementation of the Association Agreement and DCFTA would symbolize a dramatic decrease of influence of the Russian Federation in the Republic of Moldova or, at least, would demonstrate that European Union is capable to counterbalance this influence. From this point of view, the somewhat formal participation of the Transnistrian region in the

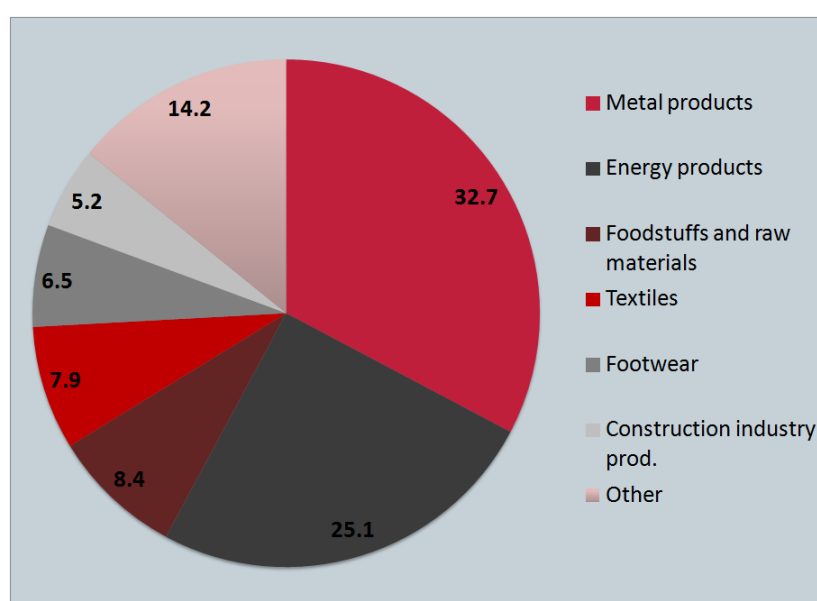
negotiations related to DCFTA should be regarded as a deliberate political strategy, rather than a result of human resources or interest lack. Recently, authorities from Transnistrian region have adopted numerous decisions in order to ensure the convergence with the Russian legal standards and not the Moldovan or European ones. Respectively, the invitation to participate in negotiations related to DCFTA does not go in hand with the geopolitical aspirations of the Russian Federation and with the dominant visions of the political establishment in the region.

■ Trade of Transnistria with the Republic of Moldova and EU

Overview

In the past few years, the Transnistrian economy has constantly lost its competitiveness, which is proved by the accelerated increase in trade deficit (from 53.3% of Regional Gross Product (RGP) in 2005 to around 100.5% in 2011) and of current account deficit (from 41.5% of RGP in 2004 to the astronomical level of 90.4% in 2011). The regional vulnerability to external shocks is fairly high, given that trade volumes exceed more than twice the RGP. This exposure is accentuated by a moderately-high level of exports concentration, both according to products-type structure, as well as according to geographical destinations. As can be seen from Figure 1, regional exports are dominated by 3 industrial branches: metals and articles from metals, energy products and products of light industry, which hold for 80% of total exports¹. In turn, these are produced by few large companies. Thereby, metals and metal articles industry is to a great extent represented by Moldovan Metallurgical Factory, which ensures a third of total revenues of regional exports. Energy industry is predominantly represented by the Energy Power Plant with Regional Heating, while the light industry – by a small number of companies specialized in producing clothing articles, shoes and other textile articles. In this way, Transnistrian economy is concentrated both at the level of industrial branches, as well as at the level of number of companies in each branch. This exposes the region to significant risks.

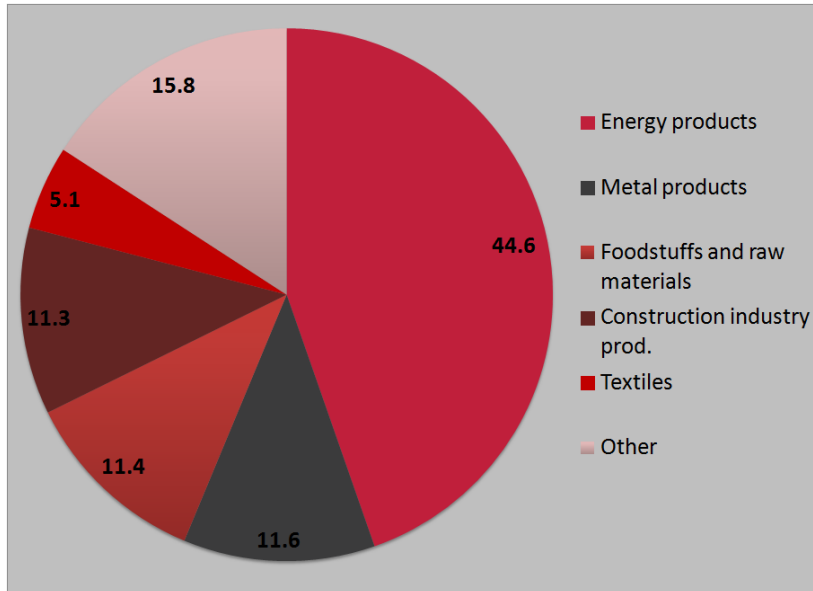
Figure 1: Transnistrian exports structure according to the main categories of goods, 2011



Source: "Ministry of Economy" of Transnistrian region;

¹ According to the data for 2011th year

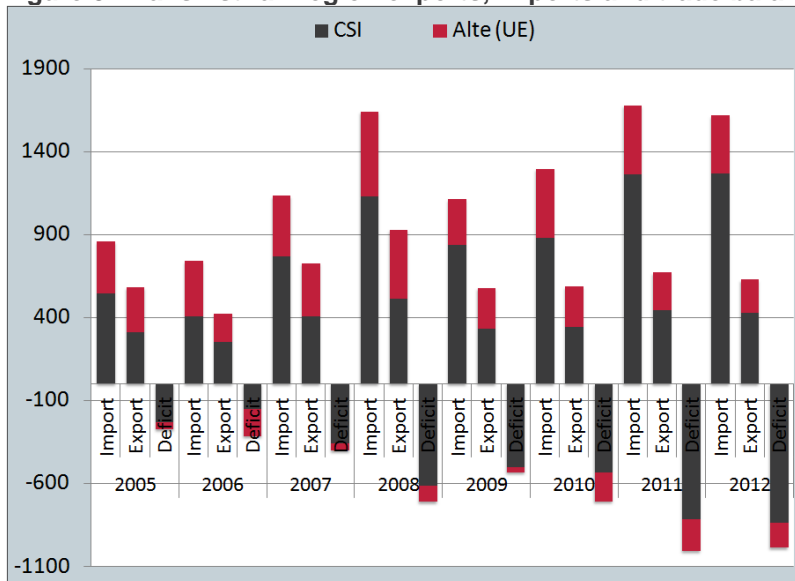
Figure 2. Transnistrian imports structure according to the main categories of goods, 2011



Source: "Ministry of Economy" of Transnistrian region;

Generally, imports structure is determined by the regional economy specifics (Figure 2). The predominant industrial branch (36.1% of the RGP in 2011) explains the strong dependence of Transnistrian economy on the energy products, which account for about 45% of total imports. At the same time, the comparative analysis of exports and imports emphasizes that, actually, the economy has very few competitive advantages. These rely, mostly, on the metallurgic and light industries, where the volume of exports exceeds that of imports. For all other goods the region is a net importer, trade balance deficit being in a progressive growth for the past few years (Figure 3).

Figure 3. Transnistrian region exports, imports and trade balance, mil USD



Source: "Ministry of Economy" of Transnistrian region;

An analysis of the exports concentration level suggests also a low degree of competition in the region, which is caused, in fact, by the numerous policies directed against competition, including, political protection granted to several large companies. About 58% of the goods are commercialized on two markets: on the Republic of Moldova territory from the right bank of Nistru

river (35.8%, especially, electricity) and the Russian Federation (22.2%)². The concentration indicator, Herfindahl-Hirschman, calculated for the Transnistrian region exports, is estimated to 0.21 points for the structure of exports according to geographical destinations and 0.19 points for exports structure according to categories of goods. This suggests a moderate level of concentration, close to the threshold of the high concentration level (>0.25 points). The low degree of internal competition undermines Transnistrian economy competitiveness externally, given that the economy is predominantly based on the industrial branches inherited since the soviet period.

Trade with European Union

Even though Transnistrian region is not recognized by the international community, all trades operated by the residents of the region with the rest of the world are registered by their commercial partners as imports and exports. For example, if a company from the left bank of Nistru river, which is not registered in Chisinau (is not a fiscal resident or, for the sake of using the same expression as the one used by Chisinau, “has no relations with the state budget”) delivers some goods to another company which is located on the right bank of Nistru river, the former will register this operation as import. This is the case for the energy products, which account for 2/3 of Transnistrian region exports to Moldova.

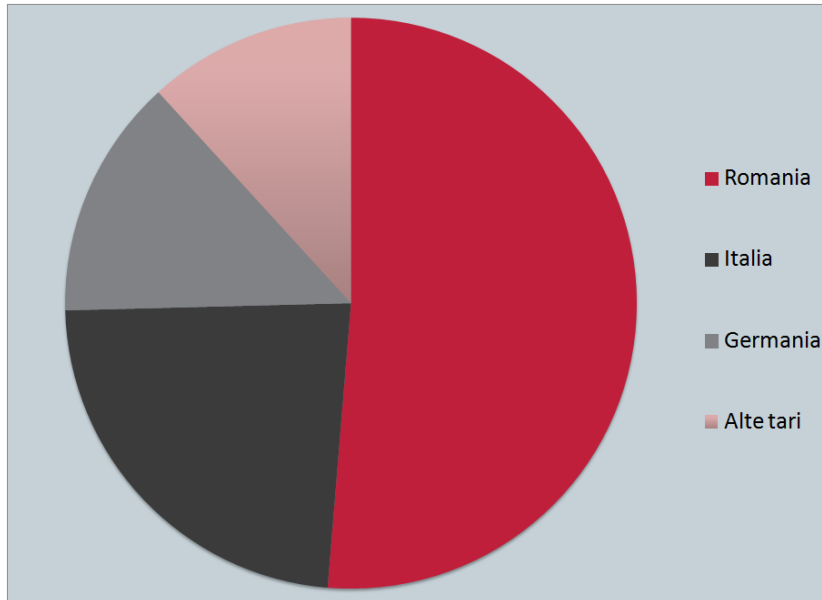
Transnistrian exports to the European Union are conducted under the Autonomous Trade Preferences regime, according to which companies from the region can deliver goods to the EU market in a duty-free regime, within the quotas set for the Republic of Moldova. The main condition is that these companies should be registered at the State Registration Chamber. At the same time, when it comes to imports from EU, there is a special customs tariff applied, enforced on the territory of Transnistrian region. Therewith, authorities from Chisinau do not collect any customs tariffs on those products, under the condition of “their remaining on the territory which is not controlled by constitutional authorities and their declaration as determined by Customs Service”³. This applies to all businesses, registered and not registered at the State Registration Chamber.

The historical past, as well as the political orientation of Transnistrian region authorities, naturally, have influenced the geographical structure of its foreign trade. So, at the beginning of 2012, CIS countries served as a destination for 68% of the region’s exports and as a source of 78.3% of the region’s imports. Respectively, the share of EU is a relatively modest one, but not insignificant, with 29.1% of exports and 15.1% of imports. (If we consider the fact that the trade between Transnistria and the Republic of Moldova is not, in fact, foreign trade, the share of EU in Transnistrian exports reaches 40%). Curiously, the main EU export partner is Romania, which absorbs about half of the total exports of the region oriented to EU (Figure 4). Other important community partners are Italy and Germany. Thereby, around 87.3% of exports of the region to EU flow into these three markets.

² According to the data for 2012th year

³ Government Decision no. 1001 of 19.09.2001

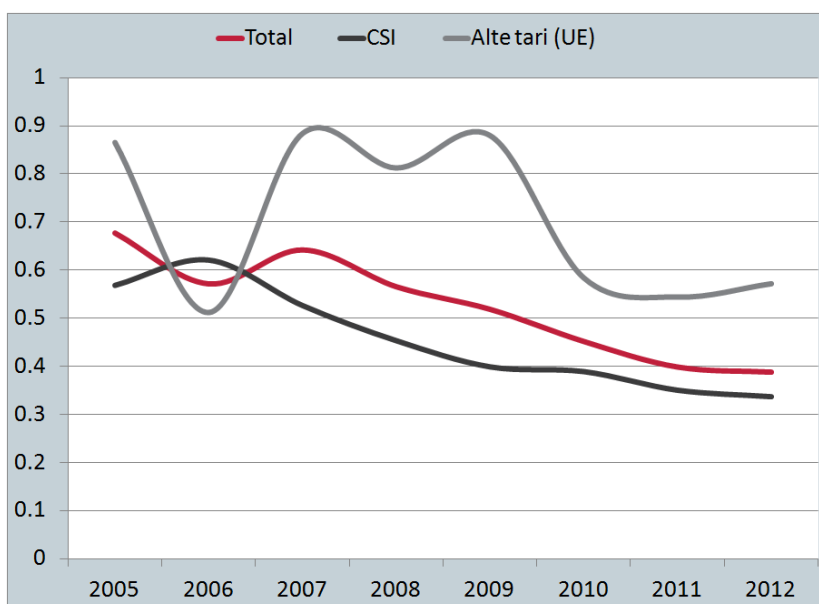
Figure 4. Country-structure of Transnistrian region exports to EU



Source: "Ministry of Economy" of Transnistrian region;

The main categories of goods exported by the Transnistrian region to EU are textiles and diverse products of the light industry. These industrial branches are represented by small companies which – as compared to the 2-3 industrial giants in the region – manage to be more flexible in adjusting their standards to the community quality standards. In parallel, even the most important company in the region, which ensures a third of total exports, Moldovan Metallurgic Factory, directs about 31% of its production to the community market. Overall, speaking about the Transnistrian region, the level of imports coverage by exports to European Union is more favorable as compared to the CIS states. This suggests that some companies from the region succeeded to find their community market niche and reveals the strong motivation of the business environment of Transnistria to maintain EU as an important trade partner.

Figure 5. Replacement level of imports by exports (exports/imports)



Source: "Ministry of Economy" of Transnistrian region;

It is important to mention that the Autonomous Trade Preferences system, granted by EU to the Republic of Moldova, allowed Transnistrian region companies to export to EU in a duty-free regime. At the same time, the region enforces its tariffs on the imported goods from EU. After the implementation of DCFTA, the Autonomous Trade Preferences will be eliminated, which makes further fuels the reluctance of Transnistrian authorities to get involved into the negotiations on the free trade agreement. If Transnistrian authorities will not undertake the necessary regulatory adjustments following the DCFTA provisions, economic agents from the left bank of Nistru river could easily remain out of the agreement. As a consequence, European Union will apply a custom tariff on imports from the Transnistrian region of 10% on textiles and about 17% on all the other goods (which will be listed as goods of unknown origin). The probability of this scenario is fairly high, taking into account the so-far resistance of Transnistrian authorities regarding the harmonization of the regulatory framework to EU norms, as well as the strong political affinity of the region's leaders for the idea of Eurasian integration.

Therefore, DCFTA implementation only on the territory controlled by Moldovan authorities could generate an immediate negative economic shock for the majority of exporting companies from Transnistrian region. It would lead to increased prices on the community markets for their goods and, respectively, would affect their competitiveness. This aspect, coupled with the critical need for structural and geographical diversity of Transnistrian exports, but also of the overall economy, could be used by Chisinau to determine Tiraspol being more cooperative regarding DCFTA implementation. However, if we accept the hypothesis that this resistance will last and the free trade area will be created only on the right bank of Nistru river, it is likely that even more companies from the Transnistrian region will permanently register in Chisinau in order to benefit of the liberalized regime with EU. The reason is that, in order to be able to export to EU, in addition to registering with the constitutional authorities, a fundamental clause relates to compliance of the rules of goods origin and insurance of necessary conditions for Moldovan authorities to verify production conditions on site.

■ Potential impact of DCFTA on Transnistria

Improving trading conditions. With a foreign trade worth exceeding 2.4 times the Regional Gross Product, Transnistrian region is critically dependent on the foreign trade. DCFTA will have a positive impact on the trade activities of the region, given that, possibly, exports to EU will be done free of tax (bringing higher turnovers for producers), while imports, similarly to the whole territory of the Republic of Moldova, will be gradually liberalized for the sensible products. Investment products and raw materials are expected to be liberalized sooner than other items. Metals, textiles, and apparel items will remain, for a short time period, the most competitive Transnistrian export articles to the EU markets. For example, for the Metallurgic Factory from Rabnita, the European market is a fairly attractive one, especially since EU did not introduce for Moldova any quantitative limitation on exported steel (in contrast, Brussels has an annual quota for Ukraine). At the same time, it is worth mentioning that if Russia will cease subventions for energy products, the competitive margin of Transnistrian producers in the heavy industry could considerably shrink. However, producers from light industry (textiles, apparel items, shoes) who export a great part of their production to Italy and Germany, have a higher degree of "real" competitiveness. It will be amplified once trade barriers are cancelled. From the other side, this competitiveness level could be undermined if EU will have to introduce customs tariffs on the imports from Transnistrian region.

Short-term loss of a small part of budget revenues in the region. In 2007-2011, budget revenues from customs tariffs and other taxes related to external economic activities represented,

on average, 7.7% from all budget revenues of the region. Cancellation of customs tariffs for the goods imported from EU and Turkey could lead to losing 10-15% of customs revenues; however, the overall impact on the budget of the region would be negligible (a decrease of 0.9-1.0% of budget revenues). At the same time, the loss of the revenues from taxing foreign economic activities could be compensated by larger revenues from direct taxation, due to extended economic activity.

Increase in consumers' utility. The introduction of DCFTA will certainly lead to a greater diversity of goods available on the market. Also, theoretically, the decrease of customs tariffs on imports could result in lower prices for the goods imported from EU, which will boost the utility of consumers in the region. Additionally, this impact is conditioned by ensuring an authentic competition between importers. If there is only one company controlling the whole retail trade network in the region, it is difficult to believe that there will be a decrease of final prices for consumers, once customs tariffs will be abolished.

Unlocking the agricultural and food industry potential of the region. In the past 20 years, agriculture and food industry of the region have degraded. Even though there were important competitive advantages regarding food production (including canned fruits and vegetables, meat and dairy products), Transnistria switched from a net exporter of food products to a net importer. Taking into account the increase in global prices for food products and the increase in the demand from EU countries for organic items, exports liberalization to EU offers a great chance to largely explore the potential of this sector and to diversify its economic base.

Increase in capital investments. Improvements in trading conditions always go in hand with increase in investment capacities, as a result of higher turnovers of producers and exporters. In Transnistria case, the regional investment capacities will be complemented by larger investments, either from Russian owners' side, or from a new wave of investments from the Republic of Moldova or EU. Investments are imperative for maintaining and modernizing production capacities of the region, as well as for a full exploration of its potential.

Normalization of trading relations with the agents from the right bank of Nistru river. Regardless of 20 years of independent development, Transnistrian economy remains strongly connected to the economy from the right bank of the Nistru river. Trading activities with agents from the right bank of Nistru represent about 12-13% from the total trading activities of the region, while in case of exports it reaches 30%. However, trade relations cannot have a normal development due to multiple barriers instituted in the region. DCFTA is expected to function as a catalytic factor to normalize the economic relationships between the two sides of Nistru.

Normalization of the economic life in the region. Given the political ambitions of region's authorities, Transnistrian companies operate in a difficult environment. This increased the risks and financing costs, which impeded the full exploration of all industrial possibilities in the region. In this way, even though the Metallurgic Factory from Rabnita is one of the largest in Europe, 75% of its production capacity being oriented to export, in 2012 it operated at only 1/3 of its full capacity. We would like to mention that in the process of this document elaboration, there was published the information according to which two largest companies in the region – Moldovan Metallurgic Factory and Cement Factory – have suspended their activity at the beginning of 2013th year⁴. DCFTA implementation will give the possibility to fully explore the current potential and to encourage the

⁴ «В Приднестровье простаивают два крупнейших завода», <http://www.nr2.ru/pmr/426851.html>.

region to get out from “underground”. Evidently, an essential question is whether authorities from the region have the same purpose.

■ Economic risks in Transnistrian region

A summary of available studies and statistical data published by the authorities from Transnistrian region clearly demonstrate that the region is confronting a series of major economic problems and risks, which could easily transcend into political or social ones:

- The economic vulnerability of Transnistria is fairly shocking, as it is demonstrated also by the increase in the current account deficit, from 41.5% of GRP in 2004 to the astronomical level of 90.4% in 2011. There is no doubt that this level is an unsustainable one and it creates great pressure on the “regional currency” rate. Actually, Transnistrian authorities have used the depreciation of Transnistrian rubles to partially finance this deficit. In 2005-2012, there was a 37% depreciation of the Transnistrian ruble with respect to the US dollar.
- The largest part of the added value, export and budget revenues is generated by very few large industrial companies, strongly integrated into the political life of the region. Particularly, about 40% of the industrial production is provided by the Moldovan Metallurgic Factory. Taking into account the types of used raw materials and products variety this is an atypical company for Transnistria and the Republic of Moldova in general. SME sector is really small and vulnerable to adverse economic conditions, as well as to administrative and political pressures in the region.
- In conditions of considerable or even excessive dependencies of the economy of the region on external markets regarding raw materials and marketplace, the access to these markets is not guaranteed. By adopting its own trade policy, not recognizing the Moldovan customs authorities and by introducing the “special” customs tariffs for the deliveries from the Republic of Moldova, the region practically has self-isolated. Because of the “siege state” sentiment, cultivated by the regional authorities, companies have short-term development plans only, while a great part of their profits are expatriated through ambiguous channels.
- The fiscal system in the region is an unbalanced one, being the object of some arbitrary political decisions. The corporate income taxes vary from one sector to another. At the same time, the volume and structure of expenses, and fiscal responsibilities are unsustainable. In 2011 the budget deficit reached 14% of GRP (the record level of -22% was reached in 2009). The main expense item in the budget of the region is social payments. However, with no direct financial support from Russian Federation, public sector salaries and retirement pensions would go as low as 40-60% of their current amount.
- Without a political and legal independence, the region has no access to international financing, while the “public” debt, which was already cancelled (estimated at 450% of the Regional Gross Product), considerably exceeds the capacity of the region to repay it. The accumulation of a huge foreign and domestic debt and running on astronomical budget deficits cannot last for too long.
- Price and tariffs policy is also based on an unsustainable model. For some services and public utilities current tariffs do not cover even 75% of the production costs. Currently, it is possible to maintain this policy only due to the “generosity” of the Russian Federation.

- The domestic market of Transnistria is very limited and volatile, the purchasing power of population depends on wages and taxes paid out by the few giant companies, as well as on remittances and on humanitarian aid provided by the Russian Federation. There is no vibrant sector in the region yet, while private initiative is subject to multiple arbitrary and unclear regulations.
- The physical and moral degradation of the production capacities in the region, including in the key-companies, involves sizeable risks. By benefiting of the energy resources at subsidized prices, companies did not invest into technological modernization. According to some estimates, over 80% of all production funds are highly depreciated. In such conditions, Transnistrian exports, including the ones to EU, are competitive due to using raw materials and energy resources provided by the Russian Federation at subsidized prices. Taking into account the cost of delivered gas and the provided financial help, this costs Russian Federation increasingly more, from one year to another. For 2012 these are estimated at 700 mil USD. It is hard to believe that such a generous support could last for long. Actually, in 2013 the tariffs for gas used by the economic agents in the region have already started to be raised. An unexpected cancellation of the subsidized prices could create significant competitiveness problems.
- Due to natural and emigration-related factors, the region is in an acute demographic crisis. In the period between 2007 and 2011 the population decreased by a yearly average of 1% (sic!). The occupation rate has dramatically reduced from 48% in 2007 to 39% in 2011. All together, these amplify even more the long-term pressures on the budget of the region.

The above stated risks are of such amplitude that, without a direct and indirect support from Russian Federation, the region would economically collapse in several months. This acute dependency of the region on the Russian Federation explains the limited autonomy of the authorities in the region when it comes to negotiations with Chisinau. It also explains the strong redundancy of these authorities, from a conciliated position in 2011-2012 to a more obstructive one in the second half of 2012. Actually, it can be said that in the last few months, the authorities from Tiraspol no longer negotiate from their own position, but they promote a geopolitical agenda of the Russian Federation with respect to the Republic of Moldova.

■ What happens if Transnistria refuses to implement DCFTA?

It is interesting that trading policy decisions adopted by the Republic of Moldova led to worsening relations with Transnistria and to tightened rhetoric of authorities from Tiraspol. In this way, in 2001, after the adherence of Moldova to the World Trade Organization, Transnistria has been deprived of the official custom stamps, which allowed it to independently participate in the international trade. In 2003 the Government decided that economic agents from Transnistria can do international transactions only after registration with the State Registration Chamber of the Republic of Moldova. Even though Tiraspol introduced some “compensatory” custom measures, Transnistrian companies have adapted to the new requirements. In 2003 there were 320 registered agents. Presently, there are 892 agents. Respectively, the vast majority of largest exporters from Transnistria are already legally registered in Chisinau. Thus, even though regional authorities declared that they are confronting an “economic blockade”, companies from the region chose a more practical solution.

The majority of business representatives from Transnistria have adopted a pragmatic position with respect to trade liberalization with European Union and they are ready to support the process of

economic opening of the region. Economic experts from the region also anticipate positive economic effects on the region from DCFTA implementation. A sober analysis of the economic risks and recognition of the positive impact which could be brought by DCFTA should suggest to regional authorities to rather accept the extension of DCFTA on the Transnistrian region. However, political interests and the overwhelming Russian Federation influence, most probably, will determine authorities to adopt an irrational behavior, from the economic point of view.

The key-question is what should be the reaction of Chisinau or Brussels, in case of Transnistrian authorities' refusal to join DCFTA, either before its official signing, or after. In the process of possible solutions identification it is very important that any option should be compatible with visa liberalizing regime with EU. This process assumes the existence of a strict control system at borders, and it should be led by the fundamental goal of economic and political reintegration of the country. In Table 1 are included and analyzed the potential solutions available to Chisinau and Brussels in case Tiraspol officially rejects DCFTA. As it can be noticed, there is no "good" solution, each of the possible answers having certain risks and costs implied to all participants.

Nevertheless, in the process of searching for the optimal solution it is extremely important, especially for the European partners of Moldova, not to ignore the fact that the economic integration of the Republic of Moldova in EU is a premise for the Transnistrian conflict resolution and not vice versa. By engaging in the process of political and economic proximity of the Republic of Moldova, EU knew from the very beginning that Transnistrian conflict represents an enormous problem, unbearable for Moldova on its own. As can be concluded from Table 1, the best solution for the Republic of Moldova and European Union, in case Transnistria refuses to recognize the validity of DCFTA on its territory, is... to continue the persuasion process. The most optimal strategy in this sense is creation of a system of incentives for the Transnistrian region companies, so that these could adjust their production processes to EU requirements. At the same time, they could create a lobby at the level of political elites from the region in order to harmonize the regulatory framework to EU principles. So, as unlike in the right bank of Nistru, where the "leadership" process was undertaken by the political elites, in Transnistrian region the stakes are on the fact that economic elites are interested in the harmonization of the regulatory framework from the region to the community norms. The importance of this finding is crucial, in the context of continuously diverging political and economic interests in the region.

DCFTA implementation on the custom territory controlled by the constitutional authorities only, in parallel with annulment of the autonomous trade preferences for the region from the left side of Nistru could have extremely negative consequences for Transnistrian economy. This also increases the risk to jeopardize the efforts of country's reintegration. Consequently, it is important that authorities from Chisinau negotiate with Brussels the implementation of DCFTA on the whole territory of the Republic of Moldova (including Transnistria). In parallel, verification of compliance to the rules of origin on the left side of Nistru is to be done, in addition to the current measures (custom representatives access, with no uniforms), through indirect measures: establishment by Chisinau authorities of some monitoring and control offices along Nistru river and of some similar offices, in cooperation with EUBAM mission, along the border between Moldova and Ukraine. This will allow a more rigorous check of the foreign trade of the companies from Transnistrian region, such that Chisinau and Brussels authorities would be able to approximate with some degree of precision if the rules of origin are respected in eastern districts of the Republic of Moldova.

Table 1. Possible benefits and risks of the available options if Transnistria does not accept DCFTA

Options	Benefits	Risks and Costs
<i>1. Establishment of a customs border between Moldova and Transnistria</i>	<ul style="list-style-type: none"> • Securing trade flows between EU and the Republic of Moldova; • Compliance to the rules of origin; 	<ul style="list-style-type: none"> • Reversal of the current course of country reunification; • Risks of confrontations and conflicts along the security zone; • Stronger internal isolation of Transnistria;
<i>2. Suspension or postponement by EU of DCFTA signing or ratification (with ATP annulment)</i>	<ul style="list-style-type: none"> • Protecting EU trade interests; • Avoiding a EU – Russia relationship crisis; 	<ul style="list-style-type: none"> • EU and European Neighborhoods Policy image break; • Alliance for European Integration image break; • Excessive Russian influence consolidation in Moldova and Eastern Europe; • Establishment of an anti-European government in Chisinau;
<i>3. Suspension or postponement by EU of DCFTA signing or ratification (without ATP annulment)</i>	<ul style="list-style-type: none"> • Protecting EU trade interests; • Avoiding a EU – Russian relationship crisis; • Preserving the access to EU markets for Moldova, including Transnistrian companies; 	<ul style="list-style-type: none"> • EU and European Neighborhoods Policy image break; • Alliance for European Integration image break; • Excessive Russian influence consolidation in Moldova and Eastern Europe; • Implicit encouraging of an irreconcilable behavior of Transnistria;
<i>4. EU unilaterally grants to Transnistria all DCFTA privileges, but requires no aquis implementation in Transnistria</i>	<ul style="list-style-type: none"> • Avoiding a EU – Russian relationship crisis; • Preserving the access to EU markets for Moldova, including Transnistrian companies; 	<ul style="list-style-type: none"> • Sacrificing EU trade interests in Transnistria; • No guarantees for rules of origin compliance in Transnistria; • Implicit encouraging of an irreconcilable behavior of Transnistria;
<i>5. EU accepts to implement DCFTA in Moldova, while for Transnistria ATP are extended for an unlimited time period</i>	<ul style="list-style-type: none"> • Avoiding a EU – Russian relationship crisis; • Preserving the access to EU markets for Moldova, including Transnistrian companies; 	<ul style="list-style-type: none"> • Sacrificing EU trade interests in Transnistria; • No guarantees for rules of origin compliance in Transnistria; • No guarantees for a definitive resolution of the Transnistrian conflict; • Creation of a dangerous precedent – including for ENP partner-states – according to which a secessionist region can obtain a separate trade status; • No motivations for Transnistrian authorities to adjust the region to European norms and standards.
<i>6. EU accepts DCFTA implementation for the Republic of Moldova (including Transnistria) with creation of monitoring and control offices along Nistru river and Ukraine border</i>	<ul style="list-style-type: none"> • Preserving the access to EU markets for Moldova, including Transnistrian companies; • Gradual Europeanization for Transnistria and accelerated – for Moldova; • Continuing improving the relationship between Moldova and Transnistria; 	<ul style="list-style-type: none"> • No access to the market for companies disobeying EU standards; • If the monitoring and control offices will be incautiously established, the conflict with Transnistria could escalate; • No guarantees for universal rules of origin compliance in Transnistria; • Sacrificing EU trade interests in Transnistria.

Also, Transnistrian companies which intend to enter or maintain their niche on the community market will respect the following basic requirements: (i) will adjust their production processes to the European requirements and standards (e.g. sanitary and phyto-sanitary standards, requirements concerning appearance and packaging, certain quality requirements, etc.); (ii) registration at the State Registration Chamber; (iii) allowance and facilitation of Customs Service representatives access into production units of companies; (iv) cooperation with the monitoring and control offices of Chisinau authorities.

The Republic of Moldova, with EU support, will have to develop an integrated informational system which will allow an enhanced monitoring of the trade flows; however, for this purposes, Ukrainian involvement will also be required. In parallel, it is important to continue the implementation process of measures leading to augmented confidence, closer integration of Transnistrian companies with Moldovan and European ones regarding technological chains, and communication intensification between Transnistrian and European business environments. Brussels and Chisinau could elaborate and propose to Tiraspol a development program for the region.

Obviously, the lack of a common custom policy in the region from both sides of Nistru, most probably, will remain a problem for the next period. Thus, even after DCFTA implementation on the country's territory (including Transnistria), Transnistrian administration will continue applying their own customs tariffs on the imports from EU, which, to a great extent, consist of ad-valorem taxes between 0% and 20%. EU will have to accept, at least for the first period, the persistence of this asymmetry in trade regimes, until Transnistrian authorities will understand the necessity of harmonization of their trade policy with the one of the whole country. In this respect, Moldovan negotiators will have to focus on three important aspects: (i) direct financial costs for EU are fairly negligible (around EUR 30 mil. yearly, consisting of Transnistrian custom tariffs applied on imports from EU); (ii) Chisinau authorities together with their development partners will implement programs to support Transnistrian companies to adopt community standards; (iii) DCFTA implementation on Transnistrian region granting benefits to companies obeying European requirements (their number will not be large at the beginning) will determine the business environment to exert pressures on the political elites so that EU requirements are applied.

Conclusions

DCFTA enforcement will indicate important changes for the Republic of Moldova. One of the most important aspects is reduction of the excessive geopolitical influence exerted by the Russian Federation on the Republic of Moldova. The Transnistrian conflict is the main instrument used by Russia to exert this influence.

The fact that the Republic of Moldova does not control the Transnistrian region generates questions and concerns regarding the way DCFTA will be implemented in Transnistria. The region confronts considerable economic challenges and risks. Its economy is structurally and financially unbalanced. The fact that it did not collapse yet is entirely due to the direct and indirect support granted by the Russian Federation.

Transnistrian economic realities suggest to the region that a wide openness regarding trading activities and insurance of a free access to the foreign markets is necessary. From this perspective, DCFTA could bring to the region a series of major benefits, including certainty and economic stability. However, economic rationale are not the dominant factor determining the behavior of authorities in the region, who, under Russian pressure, most probably, will not immediately accept DCFTA. At the same time, we expect that, in long run, tensions between

interests of economic elites (advocating free trade with EU) and of political elites from the region will intensify. This will determine authorities to adopt a more conciliatory behavior.

What are the immediate options available to Chisinau and Brussels? The identification of the optimal solution should start from the premise that Transnistrian region in no case should be separated from Moldova, while the integration process of Moldova should not be endangered. The Republic of Moldova per se cannot stay the prisoner of Moscow geopolitical strives, as well as of the unrecognized Transnistrian region authorities. For this reason, DCFTA implementation on the right side of Nistru only, in parallel with ATP annulment, currently valid for our country (including Transnistria), is not a good option, given that the conflict could escalate, instead of being resolved. Neither giving up on DCFTA implementation is a solution. This could lead to serious diplomatic and political damages to both, Chisinau and Brussels. It would compromise the European Neighborhoods Policy and would change the foreign policy vector of the Republic of Moldova. This would damage EU credibility in Caucasus countries, which are targeted in the European Neighborhoods Policy, given that those countries are also confronting territorial separatism problems.

The optimal solution is acceptance by EU to implement DCFTA on the whole territory of the Republic of Moldova in parallel with insurance of a rigorous control of all goods that are imported or exported from Transnistrian region. This would allow an indirect verification of the rules of origin compliance in the area which is not controlled by Chisinau authorities. At the same time, depending on the possibilities, customs service representatives will execute periodic visits to the production units of companies from the respective region, by complying also the requirements imposed by the Tiraspol administration (e.g. access with no Customs Service uniforms and arms, etc.). It is important for Transnistria to have access to the community programs available to the Republic of Moldova. Transnistrian companies will have to, as before, register at the official entities of the Republic of Moldova. The informational system of the customs services will have to be continuously improved, while Chisinau will need Ukraine's assistance in order to minimize the risks associated to the origin of goods. Actually, this solution is not much different from the current situation – there is no much certainty regarding rules of origin of Transnistrian exports. If EU tolerates this situation, at the price of small trade losses, there are no credible arguments to explain why it should change its approach now.

Finally, we emphasize that the right strategic approach should be that European integration of Moldova should be treated as a precondition for country's reintegration and not vice versa. Improving the business environment, increasing the competitiveness of the economy and the living standards, which are also the likely outcomes from Moldova getting closer to EU, will also facilitate country's reintegration. Actually, the Transnistrian region, due to its small dimensions and multiple structural problems has no other solution to stay economically viable and socially stable other than by diversifying markets, attracting foreign investments and fully exploring its production potential. DCFTA has to offer a wide spectrum of opportunities in this respect. Consequently, we expect that its implementation will enhance the motivation of economic elites from Transnistrian region to closely integrate with the rest of the country in order to maintain and even increase their access to the community market. This process is to be also catalyzed by the emphasizing differences between the life standards of population from the both sides of Nistru, once the European integration benefits will materialize, while the competitiveness of the economic agents from Transnistrian region will deteriorate. Gradually, these economic and social pressures will determine the political elites in the region to have a new approach, given that the interests of the economic elites from Transnistria will be more and more contradicting to the geopolitical interests of Russia.

Consequently, in order to avoid any possible tensions in the region, Russia will be forced to accept some structural reforms corresponding to DCFTA framework and to ensure access for the economic agents from the region to the community market. As a result, the European integration of Moldova will create economic motivations in the left side of Nistru. These motivations will play a crucial role in the territorial unity consolidation of the Republic of Moldova.