

Economic Cooperation between the Republic of Moldova and Romania: The Historical Background and the New Context

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Abstract: The relationship between the Republic of Moldova and Romania has a special character, being built on common language, history, culture and traditions. Despite these commonalities, the Moldovan authorities oscillated between two geostrategic vectors in the years following independence (the intensification of economic cooperation with the former Soviet states and, subsequently, the European integration), while diplomatic and political tensions between the two countries affected the bilateral economic cooperation over time. The article has the purpose to analyze the historical background and the dynamics of the economic relations between the Republic of Moldova and Romania from the period following the independence of the Moldovan state until present. For achieving this purpose, the author reviews the main political and economic events that have influenced this relationship between the two countries over time and presents the evolution of their trade and investment cooperation. The analysis finds that the bilateral trade experienced anaemic values until the establishment of the strategic partnership between Romania and the Republic of Moldova. Moreover, once Moldovan authorities signed the Association Agreement with the EU in 2014, Romania has taken over the place of the Russian Federation as the main trading partner. At the same time, Romania is one of the main foreign investors in the Moldovan economy. However, despite important progress recorded in the economic relations between the two countries, they are still far from their potential and have considerable space to capitalize the strategic partnership.

Key-Words: Republic of Moldova, Romania, Russian Federation, European integration, bilateral trade, investment cooperation

JEL Classification: F13, F15, F20, F21

1 The historical background

Economic relations between the Republic of Moldova and Romania have been established after several consecutive events that followed the dissolution of the USSR. Once the Republic of Moldova declared its independence in 1991, Romania was the first country to recognize its independence and the first to open a diplomatic mission in the new state. In the years that followed, several bilateral agreements were signed, which laid the foundations for economic and trade relations between these two states, including: the 1992 Agreement on the Promotion and Mutual Protection of Investments, the 1992 Agreement on Road Transport, the Agreement on air services of 1993, the Convention for the avoidance of double taxation and the prevention of tax evasion of 1995, the Agreement on rail transport of 1995, etc.

Despite the multitude of agreements and conventions signed, economic relations between these two states were very modest in the years following independence. This evolution was mainly determined by the historical membership of the Republic of Moldova, for almost half of a century, in the USSR. Moreover, the trade channels created during the centralized communist system between these two states, the size of the Russian Federation's market, but also the dependence of the Republic of Moldova on Russian energy resources were the main factors for the Moldovan authorities to choose the Russian Federation as the main economic and trade partner even during the first years after gaining the country's independence. Given the geographical position of the Republic of Moldova, in the „near abroad”¹ of the Commonwealth of Independent States (CIS) and in the „immediate

¹ The term „near abroad” was introduced by the authorities of the Russian Federation in the attempt to define a privileged sphere of influence for itself in Eastern Europe and Eurasia, denoting the imperial nostalgia and the desire for the restoration of great-power status. For more details on this subject see: Soroka, G., Stępniewski, T. (2020). Russian Foreign Policy Towards the “Near Abroad”, <https://spps-jspps.autorenbetreuung.de/files/06-02-intro-01.pdf>

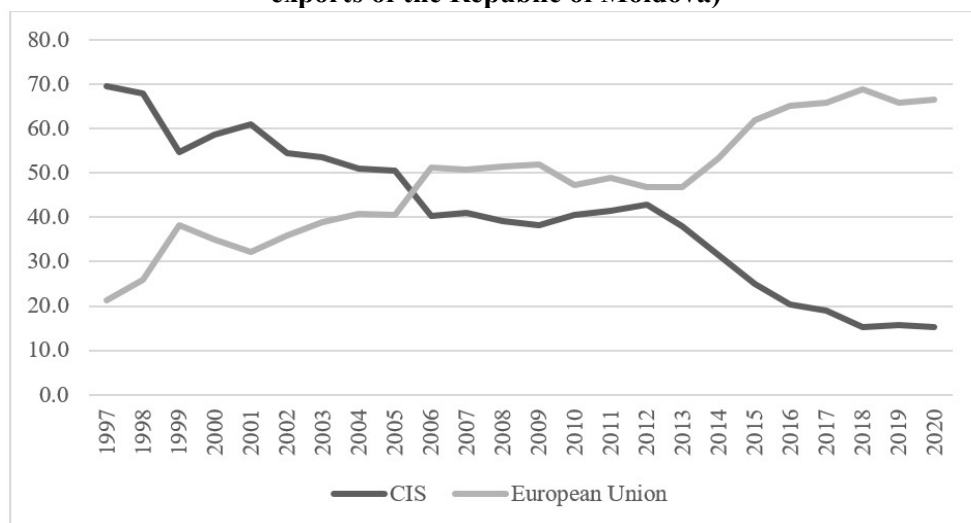
neighbourhood”² of the European Union (EU), the Moldovan authorities oscillated between two geostrategic vectors in the years following independence.

The first geostrategic vector meant the intensification of economic cooperation with the former Soviet states and was marked by joining the CIS in 1994. The second vector signified the rapprochement with the European single market and began with the signing of the Partnership and Cooperation Agreement with the EU in the same year. Accession to the CIS has led to the conclusion of bilateral trade agreements between the former Soviet states and the Russian Federation on preferential terms. At the same time, in 1999, EU integration was established as the main strategic objective of the foreign policy of the Republic of Moldova and in 2005 the Republic of Moldova - EU Action Plan was signed (Ministry of Foreign Affairs and European Integration, 2005). In the same year, the Parliament of the Republic of Moldova adopted the Declaration on the Political Partnership for Achieving the Objectives of European Integration.

Furthermore, in 2009, the Republic of Moldova joined the Eastern Partnership, an important European project which aimed to bring the EU's new neighbours closer to European values. Only one year later, the Republic of Moldova and the EU engaged in the negotiation of the Association Agreement with the EU³, a process that materialized with its signing in 2014, including the creation of a Deep and Comprehensive Free Trade Area (DCFTA, 2021).

Unfortunately, the Russian Federation saw all these projects as actions to remove ex-Soviet states from its area of influence. Coincidentally or not, in 2011, the CIS Council, led by the Russian authorities, tried to facilitate and to speed trade within the CIS, by replacing the existing bilateral free trade regime with an improved multilateral Free Trade Area agreement, abolishing customs duties and quantitative restrictions on trade between the signatory states⁴. However, this new CIS agreement did not manage to bring to life the Moldovan exports to the CIS countries. More than that, they collapsed, from 42% in 2011 to only 15% in 2020 (Fig. 1). At the same time, the establishment of the European integration path visibly increased the role of the EU as a trade market for the Republic of Moldova, from 26% in 1997 to 67% in 2020. The Moldovan exports to the EU overpassed those to CIS in 2006, rising considerably from 2014, once the Association Agreement was signed.

Fig 1. Exports of the Republic of Moldova to the CIS and the EU, in the period 1997-2020 (% of total exports of the Republic of Moldova)



Source: Author's calculations based on data from the National Bureau of Statistics of the Republic of Moldova (2021).

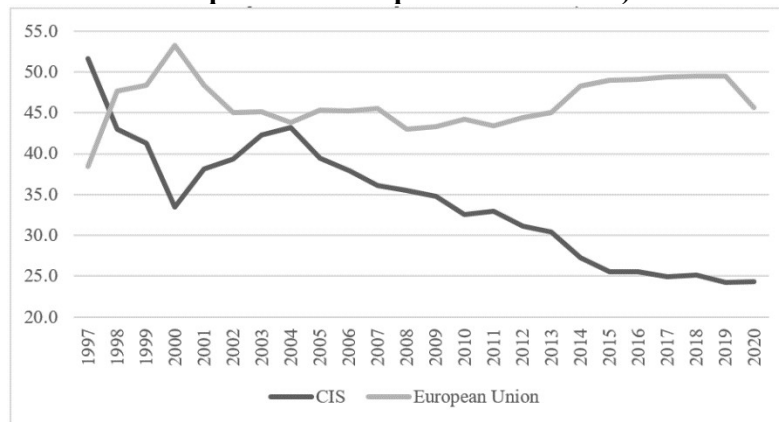
² The term „immediate neighbourhood” was used in the European Neighborhood Policy Strategy, which has been developed to establish an area of prosperity and good neighbourliness, founded on the values of the Union and characterized by close and peaceful relations based on cooperation. For more details on this subject see: Pop, A., Pascariu, G., Anghiu, G., Purcăruș, A. (2005). *România și Republica Moldova – între politica europeană de vecinătate și perspectiva extinderii Uniunii Europene (Romania and the Republic of Moldova - between the European Neighborhood Policy and the prospect of enlarging the European Union)*, Institutul European din România – Studii de impact III.

³ The Association Agreement with the EU contains binding provisions and cooperation arrangements in all sectors of interest, which have been conditional on EU budget support and macro-financial assistance programs.

⁴ The states that have joined the CIS Free Trade Area are: Armenia, Belarus, Kazakhstan, the Republic of Moldova, the Russian Federation and Ukraine.

The Association Agreement and the creation of the free trade area led also to a rise of the imports from the EU, from only 21% in 1997 to 67% in 2020. At the same time, the CIS has lost the quality of the main source of imports, collapsing from 51% in 1997 to only 24% in 2020 (Fig. 2).

Fig. 2. Imports of the Republic of Moldova from the CIS and the EU, in the period 1997-2020 (% of total imports of the Republic of Moldova)



Source: Author's calculations based on data from the National Bureau of Statistics of the Republic of Moldova (2021)

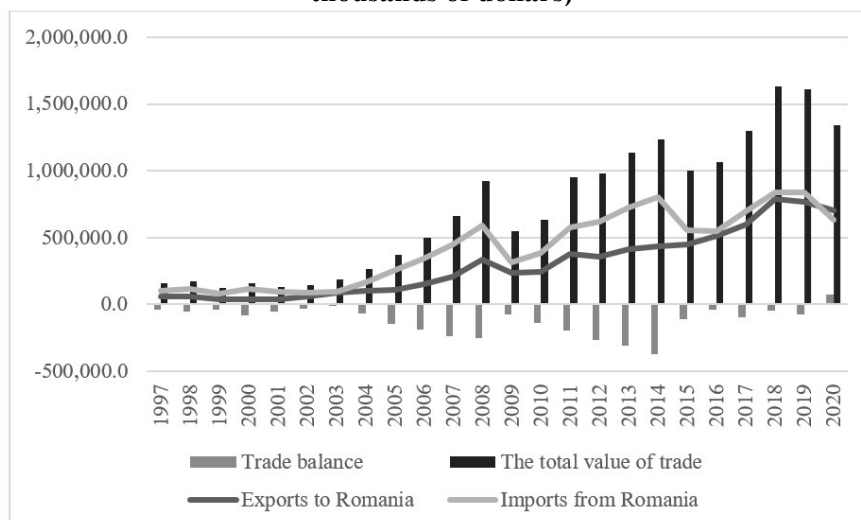
2 Dynamics of trade relations between the Republic of Moldova and Romania

During all this period, the bilateral economic relations between the Republic of Moldova and Romania were affected by a series of diplomatic and political tensions, which escalated between these two states and culminated with the introduction of the visa regime for Romanian citizens in 2009. Among the topics of tension and political controversies were found the language identity and common origins, Romania being accused by some leaders in Chisinau of expansionism and intrusion into the internal affairs of the Republic of Moldova.

In this context, the bilateral trade between the Republic of Moldova and Romania experienced anaemic values during the 1997-2005 period, rising from 160 million dollars to only 370 million dollars (Fig. 3). Although there has been a slight boost in trade relations between 2006 and 2008, the international financial crisis caused a contraction in bilateral trade by 40% in 2009.

The de-escalation of bilateral relations took place only in 2010, being signed the Declaration on the establishment of the strategic partnership between Romania and the Republic of Moldova for the European integration of the Republic of Moldova. In the same year, the visa regime for Romanian citizens was cancelled by presidential decree, and in 2011 the European integration was established as a major objective of the government of the Republic of Moldova (Government of the Republic of Moldova, 2011). These important events led to a visible rise in bilateral trade, reaching more than 1 billion dollars in 2013 (Fig. 3).

Fig. 3. Bilateral trade between the Republic of Moldova and Romania, in the period 1997-2020 (in thousands of dollars)



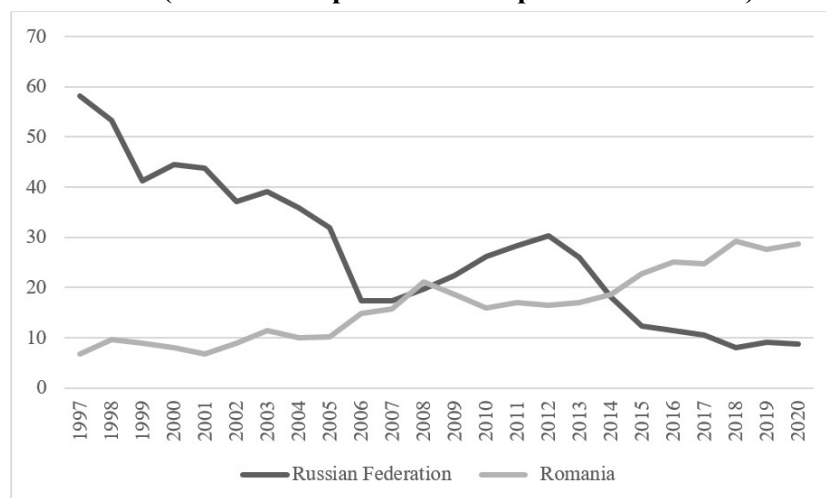
Source: author's calculations based on data from the National Bureau of Statistics of the Republic of Moldova (2021)

The acceleration of trade between these two states was triggered by a series of events related to the trade policy of the Russian Federation in relation to the Republic of Moldova. The main trading partner of the Republic of Moldova for more than 20 years, has promoted opaque rules of the game in conducting bilateral trade relations and initiated actions to restrict Moldovan imports by imposing embargoes on a number of products, since 2006. The embargoes were officially motivated by the Russian Federation due to the low quality of Moldovan products. However, each of those episodes coincided with important decisions being taken by the Chisinau authorities in favour of European integration. According to some studies, the establishment of embargoes was used as a tool to promote the political interests of the Russian Federation in the Republic of Moldova (Expert-Grup, 2010). Moreover, the political nature of the embargoes imposed by the Russian Federation was confirmed by the Russian Deputy Prime Minister, D. Rogozin, in 2014, on the eve of the signing of the Association Agreement with the EU. He argued that without a referendum, the decision of pro-European authorities of the Republic of Moldova is illegitimate and that the embargoes imposed are a reaction of the Russian Federation to this decision (Kommersant, 2014).

The first embargo, in 2006, which severely affected Moldovan exports to the Russian Federation (Fig. 4), was established after the signing of the Republic of Moldova - EU Action Plan and the establishment by the government of the Republic of Moldova of European integration as a key priority in 2005. In 2013, immediately after the Republic of Moldova announced its intention to sign the Association Agreement and create the free trade area with the EU, another embargo on imports of all Moldovan wine products followed. The consequences of these two embargoes were felt at the level of the entire wine sector of the Republic of Moldova. More than 80 wineries in the country have gone bankrupt, the area of vineyards being reduced by almost 40% (AllMoldova, 2017). The signing of the Association Agreement with the EU in 2014 determined the Russian Federation to repress imports of processed meat, fruit and canned fruit and vegetables. Moreover, in the same year, the Russian Federation approved the application of taxes on the import of several products that provided the largest share of revenues from Moldovan exports, such as wine, meat, vegetables, fruits and cereals. This measure has been applied despite the fact that the Republic of Moldova has been part of the CIS free trade area since 2011, in which Moldovan products exported to the Russian Federation were exempt from customs duties.

The lifeline for Moldovan exports was the preferential trade regime granted by the EU to the Republic of Moldova (GSP) in 2006, and the GSP+ regime, in 2007, through which approximately 7,200 groups of Moldovan products benefited from access to the Community market, being exempt from customs duties. In 2008, the list of duty-free products was extended to over 12,000 groups through autonomous trade preferences. Against this background, the Moldovan exports has taken the path to the EU markets and Romania has taken over the place of the Russian Federation. In 2014, Romania became the main trading partner of the Republic of Moldova, while the role of the Russian Federation as a market destination for Moldovan exports has considerably decreased (Fig. 4).

Fig. 4. Exports of the Republic of Moldova to Romania and to Russian Federation, in the period 1997-2020 (% of total exports of the Republic of Moldova)

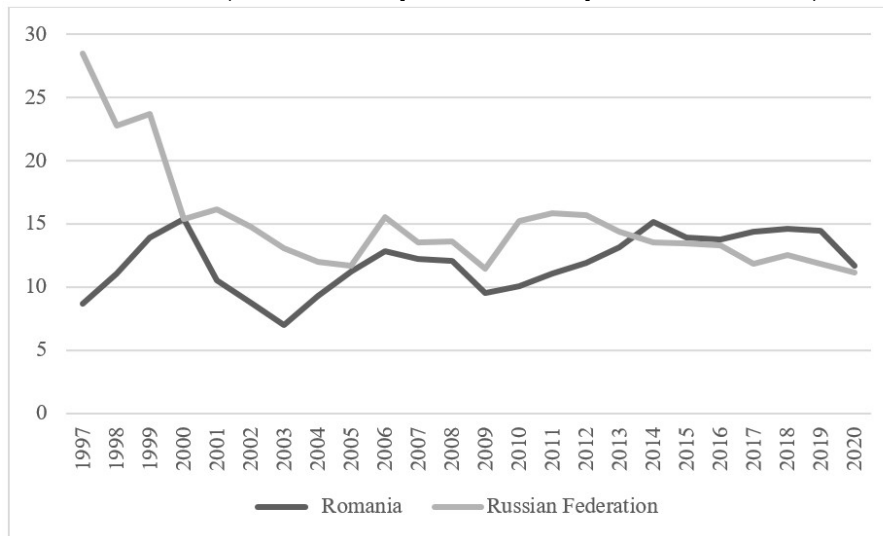


Source: author's calculations based on data from the National Bureau of Statistics of the Republic of Moldova (2021)

A similar trend could be noticed in case of imports from these two states, Romania surpassing the Russian Federation since 2014 (Fig. 5). However, given the dependence of the Republic of Moldova on Russian energy

resources, the role of Romania in this respect remains quite low. More exactly, currently, these two countries have quite similar shares in total imports of the Republic of Moldova, of approximately 11%.

Fig. 5. Imports of the Republic of Moldova from the Russian Federation and Romania in the period 1997-2020 (% in total imports of the Republic of Moldova)



Source: author's calculations based on data from the National Bureau of Statistics of the Republic of Moldova (2021)

3 The investment cooperation between the Republic of Moldova and Romania

The Association Agreement with the EU and DCFTA has helped Moldova to boost trade and create the best tools to attract international investors. The main instruments developed by the Moldovan authorities to attract foreign investors are: Seven free economic zones, distributed proportionally in the north, centre and south of the country; The Industrial Park, which offers a number of facilities, including the ability to change the destination of agricultural land for free; the right to privatize state land for construction at a normative price; free allocation of public goods to create parks at the discretion of the owner; multifunctional industrial platforms for the regional development.

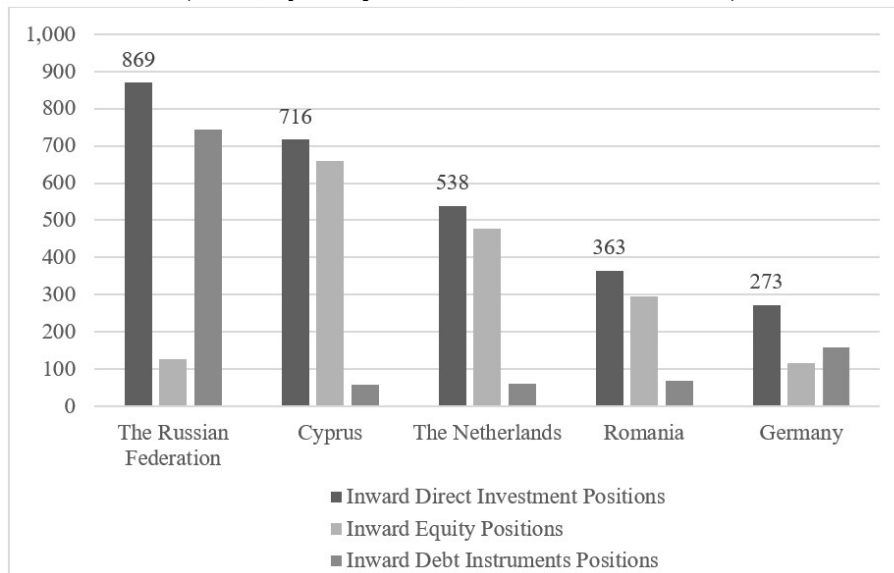
Against this background, Romania has become one of the main investors of the Republic of Moldova, holding the first place according to the number of companies registered, respectively 1,690 companies. Many of the major investments are made by investors who initially came to Romania and who, due to the similarities of language and culture, decided to expand their economic activity in the Republic of Moldova. The most notorious Romanian investments or those coming through the Romanian channel are: Rompetrol (energy), Petrom (energy), BCR - Erste Bank (banking system), Raiffeisen Leasing (banking system), Pro TV (media), Realitatea TV (media), Adevărul Holding (media), UTI (security systems), DRA Draexlmaier Automotive (electrical systems/production), Metro Cash and Carry Moldova (retail), ROMSTAL TRADE (sanitary installations), Orange Moldova (mobile operator), Arabesque (construction), Betty Ice (food industry), Ion Moș (food industry), Prices for You (apparel retailing), Teraplast (PVC carpentry) etc. More than that, the largest Romanian banking group, Banca Transilvania, that entered the Moldovan market in 2008 through BT Leasing Moldova, take over one of the third largest bank from the Republic of Moldova, Victoriabank, in 2018. Furthermore, Banca Transilvania intends to acquire 100% of the share capital of Microinvest, a company specialized in financing micro-enterprises, the leader of the non-banking financial market in the Republic of Moldova (Banca Transilvania, 2020).

Romania has so far invested 363 million USD in the Republic of Moldova, becoming the fourth largest foreign investor (Fig. 6). However, a closer analysis of investments by components⁵ reveals interesting facts. Although the Russian Federation ranks first in the list of the largest foreign investors, it has contributed mainly by debt instruments, while the equity positions are the smallest comparing to other countries. This situation dates back to 1998, when the Republic of Moldova ceded to the Russian giant "Gazprom" an important part of the state

⁵ Direct investment consists of transactions/positions of equity and debt instruments (loans, trade credits and advances, other accounts receivable/payable) between direct investment enterprises and the direct investors or other group affiliated enterprises. For more details on this subject see: BNR (2021). Direct investment - directional principle, <https://www.bnr.ro/Direct-investment---directional-principle-12352-Mobile.aspx>

company "Moldovagaz". The measure was taken as a solution to reduce the historical debts accumulated by the Republic of Moldova for natural gas supplied by the Russian Federation. The transfer took place through a transaction to convert debts to "Gazprom" into share capital ("debt-to-equity swap"), being sold including the natural gas transmission infrastructure in the Republic of Moldova. In addition, there were severe deficiencies in estimating the real value of the accumulated debt of the Republic of Moldova for the supplied gas, including the debt of the secessionist region of Transnistria (Parlicov et al., 2017). From the point of view of equity participations, Romania ranks the third in the economy of the Republic of Moldova (Fig. 6).

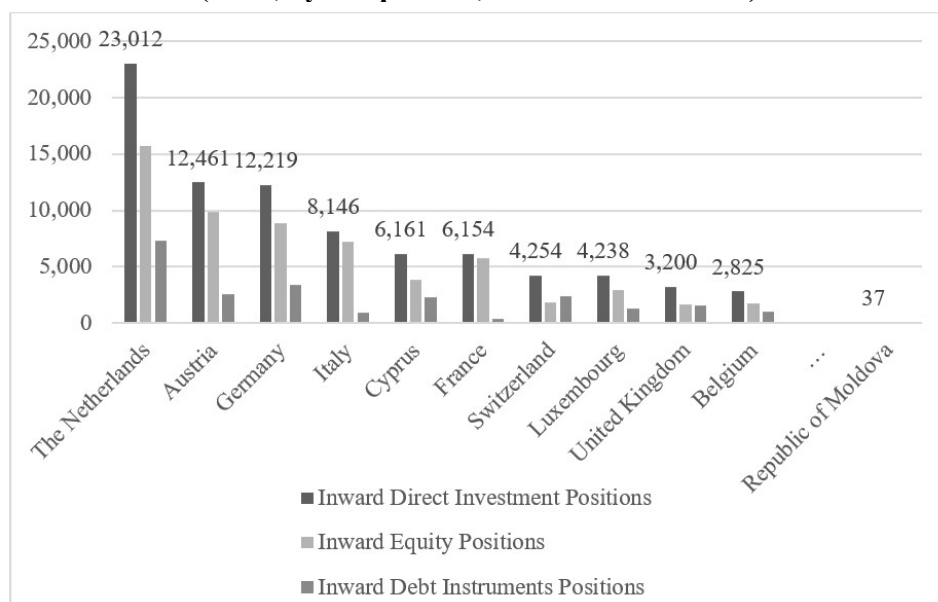
Fig. 6: The largest foreign investors in the Republic of Moldova, in December 2019 (stock, by components, in millions of dollars)



Source: Author's representation based on International Monetary Fund data (2021).

At the same time, the Republic of Moldova has invested in the Romanian economy an insignificant amount comparing to other countries, ranking only 47th in the list of the foreign investors in Romania (Fig. 7).

Fig. 7: The largest foreign investors in Romania, in December 2019 (stock, by components, in millions of dollars)



Source: Author's representation based on International Monetary Fund data (2021).

The analysis revealed that the bilateral investment relations between the Republic of Moldova and Romania became closer, while Romania is one of the major foreign investors in the Moldovan economy, ranking the third by equity participations.

4 Conclusions

The bilateral economic relations between the Republic of Moldova and Romania have been influenced over time by several important factors. *Firstly*, this relationship has a special character, being built from the beginning on the community of language, history, culture and traditions. However, the language identity and common origins were the main reasons of tension and political controversies between the two states during the 1997-2009 period, affecting considerably the bilateral economic cooperation. *Secondly*, the Russian Federation had a major role in the dynamics of the Moldovan-Romanian economic relations. The geoeconomics and geostrategic interests of this country in the South-Eastern Europe were quite obvious, when it started to impose embargoes on a number of Moldovan products, since 2006. The embargoes were motivated by the low quality of Moldovan products. However, each of the embargo's episodes coincided with important decisions being taken by the Chisinau authorities in favour of European integration. Against this background, the Moldovan exports has taken the path to the EU markets from 2006. *Thirdly*, the establishment of the EU integration objective by the Republic of Moldova in 1999 has led to important changes in the Moldovan foreign policy and in the structure of foreign trade. The European integration path visibly increased the role of the EU as a trade market for the Republic of Moldova, overpassing the CIS role in 2006. Once the Association Agreement was signed in 2014, Romania became the main trading partner of the Republic of Moldova, taking over the place of the Russian Federation.

Despite important progress recorded in the bilateral Moldovan-Romanian relations in the years following the Association Agreement, the economic relations between the two countries are still far from their true potential. In this regard, both countries have considerable space to capitalize their strategic partnership, by carrying out strategic projects in the field of energy and transport infrastructure, by liberalizing the economic space and consolidating the political dialogue.

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