DCFTA IN THE REPUBLIC OF MOLODVA: WHAT DO SMEs KNOW ABOUT IT?

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Abstract

The Deep and Comprehensive Free Trade Agreement (DCFTA) that Moldova and the EU signed in 2014 and the implementation of which started a swell in 2014 offers Moldova a unique opportunity to reach a more sustainable economic growth path. The trade restrictions that Russia imposed on Moldovan imports, however, have undermined the development potential of the DCFTA. The article is a result of a research that had as a goal to obtain a snap shot of current perception of the DCFTA impact among Moldovan SME. Over 1000 questionnaires were distributed among Moldovan SME during period from end January 2016 to early March2016. Preliminary Results were discussed in a workshop on March 10, 2016 .in Chisinau. Results and conclusions are presented.

Key words: SMEs, DCFTA, Moldova, EU

JEL classification: F150 Economic Integration

1. Introducton

The Deep and Comprehensive Free Trade Agreement (DCFTA) that Moldova and the EU signed and started implementing in 2014 offers Moldova a unique opportunity to reach a more sustainable economic growth path. The trade restrictions that Russia imposed on Moldovan imports, however, have undermined the development potential of the DCFTA.

The DCFTA's key components—liberalization of trade in goods and services, introduction of sanitary and phytosanitary standards (SPS), trade facilitation measures removing behind-the-border barriers will start to make a huge impact on Moldovan economy. The free trade area is "deep and comprehensive" since it encompasses a far-reaching regulatory approximation

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(on the Moldovan side) and market access liberalization including services, in compliance with the rights and obligations arising out of WTO membership of Moldova and the EU.

The DCFTA will remove import duties for most goods traded between the EU and Moldova. The EU is the main trading partner of Moldova. The total volume of trade in goods between Moldova and the EU reached   US$3.8 billion in 2014.

Nevertheless, After 1 year of implementation, the DCFTA has led to significant results in the Republic of Moldova-European Union trade patterns including but not limited to:

• The European Union is now Moldova's biggest trade partner with 46.4% of its trade taking place with the EU, followed by Russia (21.9%) and Ukraine (11.8%).

• Moldova now ranks 71 among the EU's trade partners, with a total turnover of EUR 3.51 billion in 2014, an increase of 8% since 2013.

• In 2014, covering the start of DCFTA application, EU exports to Moldova amounted in 2014 to EUR 2.35 billion, an increase of 3% since 2013. Key exports are machinery and appliances, mineral products, transport equipment, and chemical products.

• In the same period, the EU imports from Moldova also grew very dynamically. Total imports increased by 20%, to EUR 1.16 billion. Imports of agricultural goods grew particularly strong, noting a 30% increase. Among imported goods are mainly textiles and textile articles, machinery and appliances, vegetable products and other foodstuffs and beverages.

Despite growing trade volume, low competitiveness of Moldovan producers on the EU market remains crucial, and has also resulted in rising trade imbalances. The trade deficit between Moldova and the EU reached US$1,300 million in 2014.

SMEs in the Republic of Moldova represent around 97% of private enterprises thus making a significant contribution to job creation. Only fostering the SMEs, it will be possible for Moldova to really profit of DCFTA.

2. Methodology

The goal of this research was to obtain a snap shot of current perception of the DCFTA impact among Moldovan SME. The scope envisaged to complete at least 100 questionnaires among Moldovan SME during period from end January 2016 to early March 2016.

The content of the questionnaires was devised taking into account similar models used by international donors, key questions related to awareness and existing research. The questions were tested in a few direct interviews for adjustment and then approved and discussed with the main stakeholders such as Ministry of Economy, EU Delegation to the RM.

The selection of the SME was the most difficult mission. The approach involved:

• discussions and meetings with other major stakeholders (such as Ministry of Economy, World Bank) analyzing the impact of DCFTA on local economies

• discussions with networking institutions active in providing support to SME (Chamber of Commerce, European Business associations, ODIMM (Organization for the Development of SMEs), Local development agencies etc)

• discussions with opinion poll institutions (IMAS, AXA etc) to understand better the characteristics of the SME profile

Table 1: Risks and Impact mittigaton

Risk	Impact Mitigation
Over reliance on imprecise data (ex statistics)	Avoiding one single set of source for data sample
Lack of benchmark (no definitive data on Moldovan census)	Avoid prentention that we know for sure how many entrepreneurs are active in regions/Chisinau
Overemphasizing easy to access SME (for example ones involved in EU projects) which have a biased knowledge	Use several sets of samples - random - local chambers of commerce - industry sample (different sectors) - network based (through information mediators such as banks, agencies, etc)
Reliability of answers bias (people say what they think you want to hear)	Devised a set of questions and accompany interviews

Source: Produced by the Author

As there was no capacity to devise a single representative sample of SME, since this endeavour, currently undertaken by an EBRD project involves months of research and tens of thousands euros. However also an approach was identified that will avoid the main risks associated with that type of research. Here are the risks identified and the approach to mitigate their impact.

Our main objective being to devise an useful research and not to fall captive to methodology fallacies, we selected

- a random sample of SME based on their size, location , sector and selected from business compilers/statistical data
- a sample of active SME (participants to events, participants to business forums etc) based on attendance lists from several similar events
- a sample of SME from Chamber of Commerce, ODIMM, European Business association, Regional de development agencies (on a first come first served basis)
- Finally an additional sample of participants to DCFTA event (March 10th) with the well understood biais that they represent a much better informed community

A further challenge was represented by the lack of responsiveness and slow feedback of the respondents. As our questions covered a great deal of subjects (see above), most of the time, a single person in the company could not offer complete replies and this requested additional feedback from accounting department, general manager for example etc

The challenges of contacting SME were also compounded by the lack of precision of contact data. For example 1/3 to ½ of the contact information provided by projects or chamber of commerce data basis were obsolete. The rejection rate for phone interviews was around 80 % (4/5 calls were rejected once they learned the subject) and of those interviews which moved forward, an average of 4-5 calls were necessary per interview in order to have the questionnaires completed (initial call identify availability, call to proceed with questions answers, recalls to complete some questions) over a number of days.

The average duration of the initial successful call was 40 minutes.

No questionnaires were completed without direct coaching (phone calls or direct meeting). Replies to questionnaires sent by email without calls was exactly 0.

In total more than 1000 companies were contacted, either directly, by phone or by email to obtain a total of 140 questionnaires. As the completion of

the task took time, every few days, we have had to re assess the validity of the sample – for example, reaching out to some sectors or industries where we did not have enough replies- and to re-orientate our efforts accordingly.

The process took between February 1st and March 4th and involved an additional effort of compilation on March 10th after the DCFTA event.

3. General knowledge about DCFTA – analysis – perception

The general knowledge about DCFTA is quite low, at 20 % in the general sample and only 50 % in the sample of participants to the event dedicated to DCFTA. These scores combine replies (I know, I know somehow, I know well) for those who know and all negative replies (don't know, don't know at all)

In fact, in the general sample of 100 companies, less than 20 % pretended to know about DCFTA, and this only when the question was explained to them „ DCFTA – association treaty that Moldova has signed with the European Union „. The label „ DCFTA „ alone had an even lower awareness rate.

Of those attending a DCFTA event, completing their replies at the event itself, the rate of satisfactory awareness is less than 50 %.

The general assessment of DCFTA knowledge was a filter to pursue further questions about DCFTA impact and expectations. In fact, it is useless and prejudicial to ask SME who have zero knowledge of the DCFTA about how they expect to invest or to prepare for DCFTA. Further questions about preparation for DCFTA and related assessment were initially filtered by this general question. In short, in order to be considered relevant, answers about DCFTA preparation and needs for the SME had to be selected amongst those SME who have at least an initial knowledge about DCFTA

4. General situation of the companies

In the last 6 months, a majority of companies have observed a decline in their income and profits, in line with the deteriorating economic climate in Moldova. Although they have not provided precise figures(neither they were asked to), company managers spontaneously deplored the deterioration of trust, decline of sales, and general lack of liquidity in the economy of Moldova, the bank crashes, the Russian embargo, etc.

Almost half the respondents mentioned a decrease in their income and profits in the last 6 months, another third declared no change, and only 12 %

observed an improvement in the economic situation. The general economic climate in which the DCFTA will be applied has thus been negative and quite pessimistic, in contrast with the rather optimistic tones and approach of official public campaigns about DCFTA. The gap between the self-declared perception of the SME managers and the official communication about DCFTA is a worrying sign for future communication campaigns.

When they were asked to express their main worries, SME managers exposed at length the challenges to find customers, the relations with authorities, competition, very high costs of finance (loans), and increasing costs for energy. For the purpose of our research we have taken into account only the 2 initial answers and they are as following in order of frequency: difficulty to find clients (36 %), competition (21 %), access to finance (16 %), high costs (13 %), human resources, relations with authorities etc.

5. DCFTA impact – assessment, fears and opportunities

The next sets of questions were related to the perceived DCFTA impact, in general, for SME s, in particular, and in terms of opportunities and risks. These questions were relevant only for respondents who had at least a basis knowledge about DCFTA and their answers were gathered in order of frequency (first 2 answers)

In general, it is clear that for respondents, the main impact of DCFTA will be increased opportunities for exports and sales. Almost a third of respondents 28 % mentioned new channels of sales (exports, internet etc) as a direct consequence of DCFTA in Moldova while a similar number (27%) indicated DCFTA as been good for trade, and increased number of clients. In that matter, as a high proportion of EU and official communication about DCFTA has been geared towards promoting it as a tool to increase sales (ex : apples, fruits etc) we can consider, that for those managers who have heard about DCFTA, the main impact (positive) is expected to be increased exports and trade

A smaller proportion (9 %) of respondents mentioned improved regulatory matters as a direct benefits from DCFTA , a worrying sign if we consider that changes in administrative and procedural matters in Moldova are one of the main tasks that the local stakeholders need to undertake. Without a clear understanding of how beneficial the regulatory changes will be to the Moldovan economy as a whole, it will be more challenging to promote „

owner ship „ and changes in Moldova in processes that should primarily benefit local producers and companies.

Additionally, a small proportion of SME who know about DCFTA are interested about the beneficial aspects of technological transfers and know how transfer (11 %).

Finally, over a quarter of those who know about DCFTA believe it will bring no benefits whatsoever.

On the risk side, many companies fear EU competition (a third of those who know about the DCFTA), conformity costs (25 %). Other fears include decrease of demand (10 %), technological vulnerabilities (12 %), and interestingly enough corruption of authorities involved in DCFTA policies in Moldova (very high score among those attending the DCFTA event)

Concerning the impact on their own enterprises, SME managers knowing about DCFTA have mixed feelings, relatively balanced between negative, positive and confused. Almost half the managers believe that their revenues and costs will increase, but the impact on profits is more evenly balanced with a third pessimistic, a third optimistic and a third neutral. In short, managers expect huge changes in trading activities, but have no reason - to be overly optimistic or fearful.

In summary,while a limited percentage of SME know something about DCFTA, what they know is mostly related to the exports and trade impact which they generally will be important . The numbers of those believing that increased trade will benefit them and those believing that increased trade will harm them are generally similar, which means that one cannot assume that a simple message, „ DCFTA = more trade „ is automatically perceived as a benefit or an opportunity. It is, as we have seen, at best mixed.

What is lacking is clearly a thorough understanding of the regulatory process related to DCFTA (the deep and comprehensive standards part) which include liberalization, processes, administrative reform etc.

As mentioned   Article 173 of the Association Agreement (AA) , Moldova shall take the necessary measures to gradually achieve conformity with the EU's technical regulations, standards, metrology, accreditation, conformity assessment, corresponding systems, and market surveillance system, and undertakes to follow the principles and the practices laid down in the relevant EU legislation. With a view to reaching this objective, Moldova is expected to progressively incorporate the relevant EU laws into its legislation

in accordance by 2018. Moldova also committed to carry out administrative and institutional reforms necessary to provide an effective and transparent system that is required to implement the AA. It also committed to refrain from amending its horizontal and sector-level legislation, except for aligning such legislation progressively with the corresponding EU legislation. It is this part of the DCFTA that according to most studies will benefit most Moldovan SME (and will impact them most) and our research show a very limited understanding and acknowledgment and trust in this process .It is worth mentioning that those doubting the capacities of the state to implement properly these measures were to be found among the most informed and most involved participants at the DCFTA event.

6. DCFTA support, investment and needs

Another set of questions were related to what the SME expect and believe is necessary to receive in terms of support and how they, themselves prepare for DCFTA. Again, these questions were addressed and useful only for respondents who had at least a basic knowledge about DCFTA and they were offered a range of choices.

Among the multiple possible answers, the most frequent were market studies (35%), access to finance (30%), support for management (30%), marketing support (20%), legal support for certification and registration (26%), and support for logistic (16%).

In their statements, many managers mentioned that improved access to finance and EU loans will be a direct benefit for them and allow them to avoid the trouble Moldovan Banking sector.

On the other hand, Moldovan SMEs themselves expect to need to invest in similar way to prepare for DCFTA. Marketing (22%), quality management (24%), access to financial resources (22%), human resources (16%) and IT(16%) are the areas where the frequency of multiple possible answers are aligned with expectations of support. In short, Moldovan SMEs have a balanced understanding of what their weaknesses are (all over), expect support in that area and also know that they need to invest to prepare.

7. Ownership profile and company profiles

A set of questions were addressed to the respondents to draw a profile of their company. Here the reluctance to answer was very high, especially regarding the questions of profits, turnover, income etc, although the

consultant made very clear that this information will remain confidential. Less than a third of respondents offered complete answers to the profile questions and therefore the question related to the average income/turnover or SME cannot offer reliable answers. The only conclusion we can draw is that among those who responded, there is a great diversity of situations, from very small enterprises (10,000 euros) to huge enterprises (over 10 million euros).

Regarding the owner ship structure, almost a half (47%) of respondents has one owner only, 22 % have several owner, 18% are family owned and the rest are a different form of legal organisation.

Around a quarter of the companies are newly established (up to 5 years), 21 % have been active for 6-10 years, and the rest have more than 10 years of activity.

8. Other comments

Once they reached the end of the questionnaires, the respondents were encouraged to express their own comments and many did in blunt statements. Among the expressions shared it is worth mentioning the following:

"*What is DCFTA ... this EU stuff? We thought it was over with the Visa liberalisation*"

„*Association treaty is good. But it also should include Russia. We need to have good relations with our traditional markets*"

"*We don't know what our government has signed and we don't trust them*"

"*This is another tool for crooks to steal EU money*"

"*What we need is direct support… cheap grants*"

"*Who is going to teach is how? Really who*"

"*EU has destroyed neighboring countries agriculture and will destroy ours*"

"*Nobody stopped us from exporting until now. Those who can do already*

"*What will change I don't know*"

"*We have lost our trade with Turkey because of these EU things. We were exporting glass and ceramics to Turkey and now they have imposed tariffs on us*"

"*Europe is the only way for Moldova. There is no going back*"

"*We don't need seminars. We need help every day*"

9. Conclusions

The Deep and Comprehensive Free Trade Agreement (DCFTA) that Moldova and the EU signed and started implementing in 2014 offers Moldova a unique opportunity to reach a more sustainable economic growth path and after 1year of its implementation positive balance is assessed.

A research about DCFTA perception is a challenging endeavour because in the business community, at the moment general discussions about EU association and EU relations cannot be separated from the disappointing experience of the last years (economic/politic decline)

The general knowledge about DCFTA is limited at around 20 % of the SME sample. Even among those involved in EU events and DCFTA, knowledge and understanding (self- declared/not tested) is less than 50 %.

When they believe they know something about DCFTA, respondents know general concepts: it will help trade, possibly boost economic activity and exports. The deep and comprehensive part of the treaty is mostly ignored. The whole administrative and regulation processes evolution is ignored and not trusted. The SME don't believe in the EU positive role in local regulation and standards of doing business..

While they know that DCFTA will have an impact on trade and business, SMEs have mixed feelings about this impact. There is quite a balanced similarity of positive opinions and negative ones, i.e optimistic or pessimistic about the impact of DCFTA

When they expect help, SME expect mainly access to easy finance, help for marketing and exports, help for practical skills.

When they think foreign and technical assistance, SME expect and need direct help (forms of help desks, coaching, support for devising their presentation, data basis for identifying customers, legal and regulatory support).

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