

Fostering free trade in regions with protracted conflicts - The case of Transdniestria -

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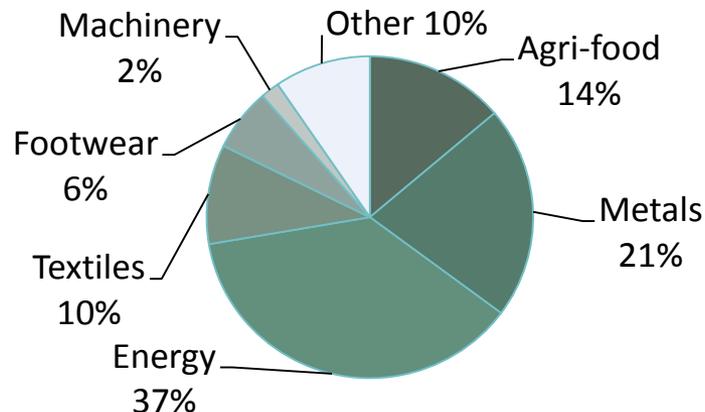
Part 1

Trade liberalisation in Transdniestria - Benefits and prospects -

Dr. Ricardo Giucci, Berlin Economics

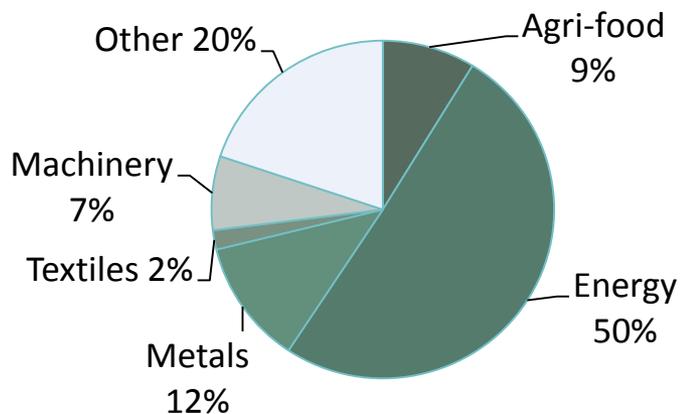
Trade in Transdniestria

Exports



Source: Customs Committee of PMR, 2015, incl. trade with right-bank

Imports



Source: Customs Committee of PMR, 2015, incl. trade with right-bank Moldova

Exports

- 70% of GDP in 2015
- Diversified structure
- Large electricity exports

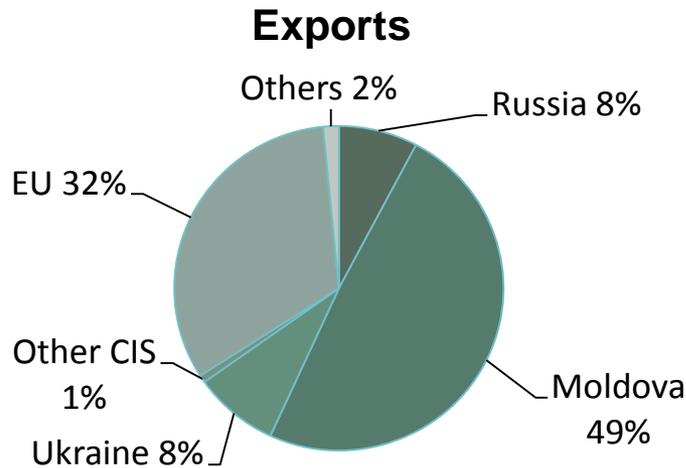
Imports

- 131% of GDP in 2015
- Large gas imports
- But many other items as well

Conclusions

- Huge importance of trade
- Unusually high trade deficit

Regional structure of trade



Export

- EU and right-bank of Moldova main destinations
- Right-bank of Moldova: Large electricity deliveries

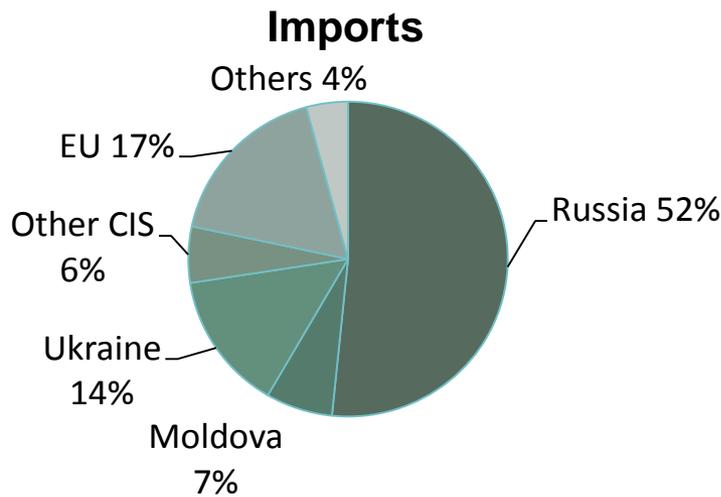
Import

- Russia: Over 50%
- Main reason: Gas imports

Conclusions

- Different structure for exports and imports
- Diversified trade structure
- Trade with East & West

Source: Customs Committee of PMR, 2015, incl. trade with right-bank



Source: Customs Committee of PMR, 2015, incl. trade with right-bank

Institutional framework for trade

Trade with the EU

- Export: Duty-free access till Dec 2015 benefiting from the autonomous trade preferences (ATPs) granted by EU to Moldova
- Since Jan 2016: Duty-free access benefiting from the EU-Moldova DCFTA
- Import: Average duty tariffs of ca. 7%
- **Thus**: Export-import asymmetry; continuous duty-free access to EU requires trade liberalisation efforts

Trade with CIS countries

- Export: Duty-free access to CIS markets
- Import: Average duty tariffs of ca. 7%; same as for EU
- **Thus**: Also export-import asymmetry

Benefits of trade liberalisation

Proposal: Removal of import tariffs for EU and CIS products; symmetry

→ Free trade with East and West

Economic benefits

- Continued duty-free access to EU
- More competition, lower consumer prices
- Improved business climate, more investments
- GDP growth
 - Free trade with EU: **+0.4% to +3.6% of GDP**
 - Loss of duty-free access to EU: **-5.2% of GDP**

Wider benefits (related to the OSCE objectives)

- Closer international integration and economic cooperation
- Confidence building between conflict parties

Challenges for achieving free trade

Fiscal policy: Removal of import tariffs reduces public revenues

- Compensating fiscal measures are needed

Cross-border transactions and trade

- Cross-border transactions are complicated and expensive

Exchange rate policy and competitiveness

- Depreciation by trading partners puts pressure on trade balance

Technical standards / SPS-measures: Challenge to access EU market

Customs: Alignment of procedures with international best practice

Competition law: Alignment with international best practice

→ **Vast challenges in various legal and economic fields**

Prospects for free trade in Transdniestria

Question: Are all these challenges manageable?

- Part 2 of presentation: How to overcome fiscal challenges
- Part 3: How to deal with challenges for competition law
- But also other challenges are manageable

→ Challenges for free trade are significant, but technically manageable

→ Transdniestria can secure free trade with East and West

Important precondition

- Good cooperation with right-bank of Moldova and other stakeholders
- Broadly speaking: Good prospects if trade issue is not politicised

Part 2

Fiscal reform in Transdniestria

Prof. Dr. Hans-Georg Petersen

Tax and Transfer Research Group Berlin (TTRG Berlin)

Reasons for fiscal reform

1. Revenue short-fall after trade liberalisation

- New revenue sources needed to compensate revenue loss after import duties on EU (and eventually CIS) goods abolished

2. Current system not conducive to trade

- No refund of indirect taxes for exporters
- Double taxation of exports and imports

3. Current system inhibits economic development

- Old fashioned tax system major barrier for economic growth

Overview of revenue structure

Revenues by type of source for 2015

Revenue source	2015, USD m	% yoy	Share of total revenues
Fiscal revenues	161.9	-29%	77%
Turnover tax	67.7	-2%	32%
Personal income tax	31.4	-21%	15%
Customs' duties	29.5	-53%	14%
Excises	12.5	-66%	6%
Other taxes	20.8	0%	10%
Non-fiscal revenues	47.6	-16%	23%
Total	209.5	-27%	100%

Source: Ministry of Finance PMR

Assessment of existing gross turnover tax

Assessment of the gross turnover tax

- ⊕ Broad tax base
- ⊕ Ease of administration

But a number of **negative** side effects

- ⊖ Taxes business regardless if profitable or loss making
- ⊖ Investments are taxed
- ⊖ Favours large integrated companies
- ⊖ Burden for small and medium size enterprises
- ⊖ Difficult to combine with international trade obligations
- ⊖ Prone to lobbying

Conclusion: Extension of gross turnover tax not advisable

Assessment of VAT

Benefits of a modern VAT:

- ⊕ Broad tax base, large revenue potential
- ⊕ Avoids negative effects of gross turnover tax
- ⊕ Equal treatment of all enterprises, boost for SME development
- ⊕ Consumption tax, companies get VAT on input refunded
- ⊕ Similar effect as import duties on import prices
- ⊕ Promotes trade
- ⊕ Decrease of tax avoidance, evasion and thus shadow economy

However:

- ⊖ Sophisticated tax administration required

Conclusion: VAT introduction maybe beneficial for Transdnistria

Efficient tax administration, low tax evasion

- Pre-requisite for VAT success: Efficient tax administration
- Otherwise risk of tax evasion and tax fraud

Requirements

- Highly developed IT system with simple software solutions
- Dedicated trainings for the tax administration, training manuals and information materials for companies and consumers
- Rapid tax collection and refund
- Electronic tax declaration
- Strictly non-cash payments
- Special VAT audits on short notice

Authorities should seek technical assistance from international partners for VAT introduction

“VAT task force” for a smooth VAT introduction

- Bilateral VAT Tasks Force should be set up, once decision for a VAT introduction is made
- Composition of international and national experts

Group of international experts

- Public economist
- Tax law expert
- Head of revenue office (of a country with VAT in place)
- Expert for tax statistics
- Technical support

Group of Transdnestrian experts

- Representatives of relevant economic and fiscal authorities
- Tax law expert
- Certified accountant
- Organisation responsible for training of tax administration
- University Chair of tax law / accounting
- Representative from parliament

Benefits of fiscal reform

Economic

- VAT = trade-friendly tax system
- Enough revenues to finance trade liberalisation
- Boost to trade and economic growth

Wider benefits

- VAT tool for improved international economic cooperation
- Possibility for VAT refund for Transdnistriean companies from Moldovan tax / customs authorities?

Part 3

Reform of competition policy in Transdniestria

Dr. Hans Janus

Chairman of German-Russian Lawyers' Association

Why modernising Competition Law?

Fair and free competition is an essential part of most free trade agreements

- International trading partners demand level playing field:
- Equal treatment of imported goods on Transdniestrian market
- No unfair advantage of Transdniestrian exports on foreign markets
- **Problem:** Current Transdniestrian competition legislation outdated, not in line with best international practice
- **Modernising competition legislation and institutions needed to promote free trade**

Which approach to follow?

Should Transdnistria follow European Union (EU) or Russian / Eurasian Economic Union (EAEU) approach?

- Developments go into the same direction
 - International trend of converging competition legislations
 - Often based on EU competition legislation
 - Russian competition law has followed
 - Modern regulations on competition in EAEU Treaty, own EAEU legislation will be issued only in coming years
- **Recommended approach: Following international best practice, i.e. EU Law and taking EAEU rules on competition into consideration**

Assessment of current law

Transdniestrian competition law...

- ...is close to Russian competition law but has not followed recent modernisations of Russian legislation
 - ...is strongly focused on natural monopolies
 - ...does not include rules on subsidies and public procurement
 - ...causes large administrative burden for businesses
- **Action urgently needed. Doing nothing means further increasing backlog**
- **Barrier for international trade and economic growth**

What needs to be done

Modernising of current competition law, by:

- Separating competition law and law on natural monopolies
 - Sharpen rules on subsidies and public procurement
 - Developing rules on international competition law cases with direct impact on trade and competition in Transdnjestria
 - Reduce administrative burden for companies
- **Avoid any further delays in legislative procedure**

Benefits

Main benefit

- Modern competition law promotes international trade and improves general investment climate

Further benefits

- Lower prices for consumers
 - Increased competitiveness for companies
 - Transdniestrian legislation harmonises with main trading partners EU and CIS countries (including Russia)
 - Improved attractiveness as investment location, including for companies from right bank of Moldova
- **Thus increased economic cooperation between both banks**

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