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Foreign direct investments – regional competitiveness of the Republic of Moldova

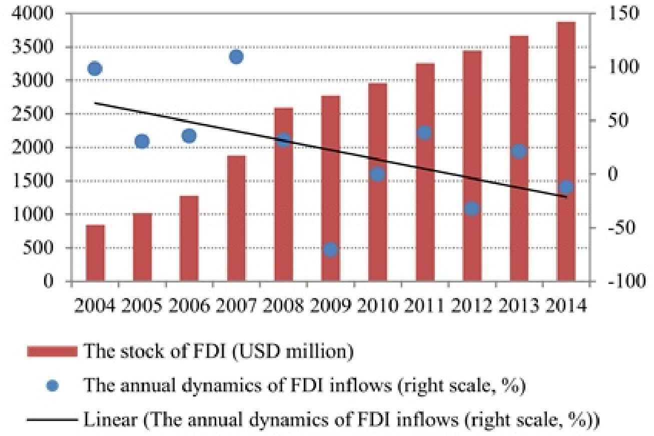
Technical box extracted from:

Inflation Report no.2, May 2015 [1]

The impact of foreign investments on a country's economy is undeniable: the chain of effects that they create has repercussions both on the production of goods and services and on the consumption, stimulating demand and supply simultaneously. Investments represent the incentive that generates new economic activities and aim at achieving goods and services indispensable for a viable and prosperous economy.

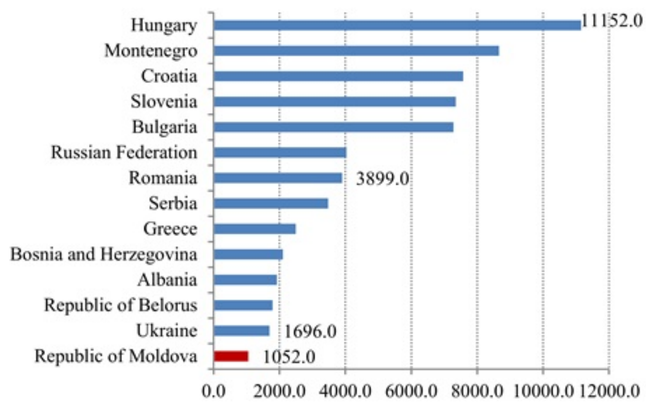
Currently, according to the Strategy for attracting investments and promoting exports for 2006-2015, the Republic of Moldova Government's strategic priority is attracting investments and promoting exports. The Government is willing to turn economy towards production activities intended for export and to make more effective the country's potential as a natural transit point between East and West. At the same time, according to the National development strategy of the Republic of Moldova for 2012-2020, the development paradigm of the economy should be changed and namely, to renounce to the growth model based on consumption fed by remittances in favor of a dynamic model based on attracting foreign and domestic investments, as well as the development of industries exporting goods and services.

Chart no. 1. Dynamics of FDI in the Rapublic of Moldova



Source: NBM, UNCTAD

Chart no. 2. The stock of FDI per capita in 2013(U.S. dollars)



Source: UNCTAD

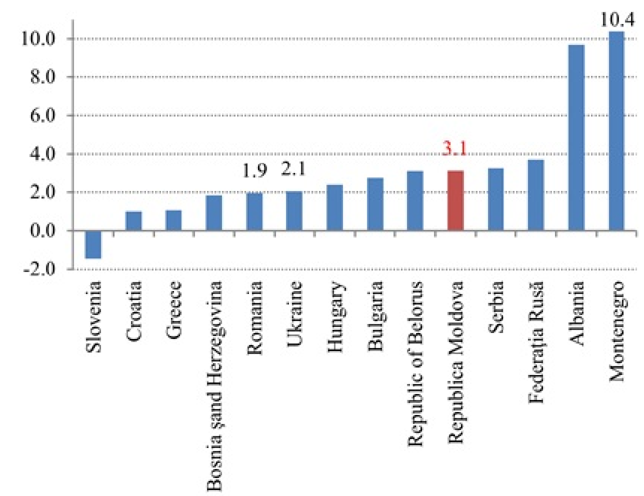
In order to achieve this objective, it is required to inject a large volume of investment in the country's infrastructure, the development of skills and economy, volume that exceeds the financing capacity of the local level public and private sector. In this regard, Republic of Moldova wants to increase the country's attractiveness for foreign direct investments (FDI) but, given the ongoing liberalization of the movement of people, goods and capital, the countries are in constant competition, including in attracting of the investments.

The existence of free trade agreements at global and regional level, reduced tax burden, relatively cheap and qualified labour, country's strategic geographical location, soil, favourable climate, traditions in manufacturing, particularly in that of agro-food products are indisputably the determining elements with a great positive imprint on investment competitiveness of the Republic of Moldova.

However, as compared with other countries in the regionCountries in the region refer to the countries of South Eastern Europe and Eastern Europe. [1], the investment climate is not an asset for the Republic of Moldova. This is shown both by the Moldova's position in international ratings and the direct comparison of the macroeconomic and performance indicators in attracting FDI between the countries. Another important point is the fact that as FDI has its origins outside the countryAccording to the NBM data, among the top investing countries (criterion: geographical distribution of FDI accumulated in capital share, on major countries, except for the banking sector) are the Russian Federation, the Netherlands, France, Spain, Germany, Cyprus, Romania, Italy, etc.
[2], an internalization process occurs, through them, in the economic situation of the countries investing in the national economy and society. The analysis of the FDI stock and flow over the last 10 years (Chart no.1) shows a steady increase in the stock of foreign direct investment (more than USD 3.9 billionAmount does not include FDI from the left side of the Nistru river and Bender city.
[3] in 2014), by 4 times more compared to 2004. However, since 2008, FDI flows recorded a downward development. Following the global crisis, FDI flows into the national economy decreased sharply. The economic and financial crisis has sharply reduced the foreign investor confidence in the capacity of the economies in transition to revive, among which is the Republic of Moldova. More investment projects have been foregone or postponed.

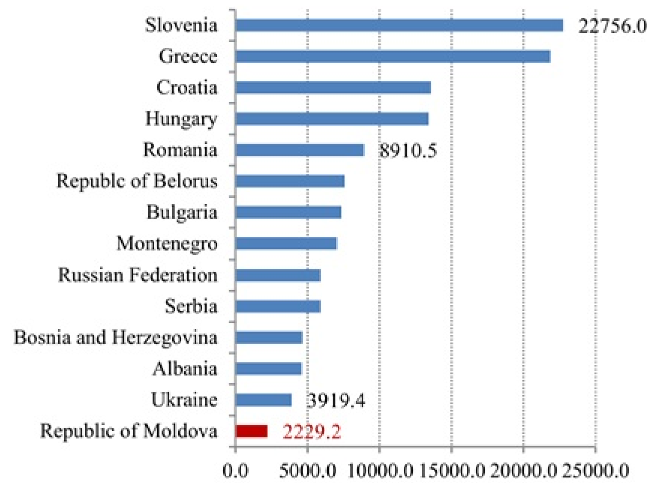
The degree of foreign capital penetration in the economy is represented in a suggestive manner by the level of FDI stock per capita (Chart no.2). Empirical data on this indicator show accentuated discrepancies between the countries in the region, the Republic of Moldova recording a low level of this indicator. Compared to other former Soviet countries in the region, Ukraine, for example, has accumulated a stock of USD 1696.0 per capita, Romania – USD 3899.0 per capita, while Hungary is on the top.

Chart no. 3. The share of FDI inflows to GDP in 2013 (%)



Source: UNCTAD

Chart no. 4. GDP per capita (U.S. dollars)



Source: UNCTAD

According to the indicator the weighted FDI flow to gross domestic product (GDP), the Republic of Moldova, compared to other countries, was ranked 5th in 2013 (Chart no.3). This, however, was not due to high FDI flows, but rather due to a low level of GDP. As a demonstration may serve the reduced value of GDP per capita (Chart no.4), although in 2013 GDP real growth was 9.4 percent – the highest in the region. At the same time, FDI flow per capita in the Republic of Moldova recorded in 2013 the level of USD 66.0 (the maximum level was recorded in 2008 and was USD 196.2). The neighbouring countries, Romania and Ukraine, recorded the best performances, reaching the level of USD 167.0 and 83.0, respectively.

With reference to international rankings, which present the index on a country's investment attractiveness, some of these indexes should be mentioned. Thus, according to a World Bank data, „Doing Business 2015", in 2014, after the ease of doing business, Moldova ranked 63th out of 189First place being considered as the best; it means that the regulatory environment is conducive to economic activity.

[4] (in 2013 – it ranked 82th). At the same time, the global competitiveness index in the ranking „The Global Competitiveness Index 2014-2015", developed by the World Economic Forum, ranked Moldova 82th (in 2013 – 89th), Romania – 59th and Ukraine – 76th. Another important index characterizing the country's investment attractiveness is the index of economic freedom, calculated by the Heritage Foundation. According to this index, in 2014, Moldova ranked 111st (similar to the previous year) out of 165 countries and was placed into the category of "mostly unfree" countries. In the same ranking, Romania is ranked 57th (in the category of "moderately free" countries), while Ukraine – 162th (in the category of "repressed" countries). With regard to the freedom of investment, Moldova ranks 109th, Romania – 23th and Ukraine – 168th.

Thus, further orientation toward business development and investment climate improvement will have positive effects on the Republic of Moldova competitiveness in attracting foreign investments, which will be expressed by increasing exports, increasing number of reliable companies motivated to implement innovations, capable of creating attractive jobs, ensure higher productivity and export-oriented competitive production. Inevitably, this will be reflected in the improvement of the macroeconomic indicators and further advancement of the Republic of Moldova in international rankings.

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[1] Countries in the region refer to the countries of South Eastern Europe and Eastern Europe.

[2] According to the NBM data, among the top investing countries (criterion: geographical distribution of FDI accumulated in capital share, on major countries, except for the banking sector) are the Russian Federation, the Netherlands, France, Spain, Germany, Cyprus, Romania, Italy, etc.

[3] Amount does not include FDI from the left side of the Nistru river and Bender city.

[4] First place being considered as the best; it means that the regulatory environment is conducive to economic activity.