

The Impact of Foreign Direct Investment on the Economy of Republic of Moldova

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Abstract

This study examines the implications of the FDI on economy of the Republic of Moldova. Using a data approach, the results show that global financial and economic crisis of 2008-2009 has strongly influenced the dynamics of FDI. Our results also demonstrate that Moldova needs to take cardinal measures to overcome the crisis phenomenon and to direct its economy on ascending development trajectory.

Keywords: Republic of Moldova, capital flow, foreign direct investment, strategy of investment attraction, balance of payments.

1. Introduction

A significant role in the globalization and internationalization of international economic relations is due to the increasing international capital flow. The intensification of capital movements between countries and regions of the world is caused by the increase of FDI, which leads to the acceleration of social and economic development of all countries. In most cases, high-rating countries targeting foreign direct investment have high economic growth indicators. FDI is presented not only as additional financial source, but also as an acceleration factor for speeding technical and economic progress, gaining access to cutting-edge technologies and techniques and advanced industrial management methods which predetermines the competitive positions of countries in global and regional markets.

Under the conditions of modern economy, the process of capital movement is subject to positive and negative changes. The financial and economic crisis from 2008-2009 significantly changed the FDI dynamics and flow. According to UNCTAD data, the inflow of FDI in the CIS countries, including the Republic of Moldova, between 2013 and 2015 fell from 62 billion USD to 30 billion USD in conditions of low prices for raw materials, the diminishing domestic market, the direct and indirect influence of the limitation measures, geopolitical tension, changes in the legislation [1].

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2. Literature Review

The theme of FDI is the subject of fundamental research of Moldovan scientists and businessmen. One of the monographs of the author N.Ciornîi, an active representative of the business, doctor in Economics, carried out profound research on FDI in the conditions of the Moldovan transition economy to the market economy and presented the investment processes between 1995-2000 [2]. The similar period was investigated by Gorobievski Sv., Gribincea A., emphasizing the reinvestment of revenues in the national economy for the refurbishment and modernization of enterprises [3, p.138].

Author Roşca P. notes in his analysis the practical aspects of international capital flows, that efficient use of FDI is the key for a successful function of national economies [4,p.94].

Further research by Doltu C. confirmed the dynamic increase in FDI from 142.9 million USD in 2000 to 512.0 million USD in 2007, including equity investments from 83.6 million USD to 266.0 million USD, and reinvested revenues from 11.7 million USD in 2000 to 190 million USD in 2007 [5, p. 119].

The dynamic increase of the FDI, the qualitative changes in the investment process have increased the efficiency of the Republic of Moldova's opportunities in improving the investment climate, bringing it in line with the market requirements, by studying the local conditions of the investment particularities, by the theoretical and practical trends and strategies for connecting to the European requirements and worldwide.

As a result of the scientific researches is published the manual "The Basics of Investment Activity", by Hâncu R., Suhovici A., Luchian I., which serves as methodological basis for new theoretical elaborations regarding the investment activity [6, p.6].

Subsequent FDI research during 2006-2010 was investigated by Gribincea A., noting the decrease in investments in 2009 from 711.46 million USD in 2008 to 145.33 million USD in 2009, or about 5 times [7, p.255].

In the subsequent research, Gribincea A. and Carbune N. carried out an analysis of the investment activity in Moldova during 2004-2011 [8, p.302].

3. The legislative and economic aspects of the organization and development process of FDI in Moldova

Legislative and economic aspects of the organization and development process of FDI in Moldova resulted in the emergence of the Law no. 81 from 18.03.2004 regarding investments in entrepreneurial activity, published: 23.04.2004 in the Official Gazette of the Republic of Moldova, no. 64-66, no. 344 [9]. In this law, art. 3, a series of notions are formulated, where *investment* is defined as the totality of the assets deposited in the entrepreneurial activity on the territory of the Republic of Moldova, including on the basis of the financial leasing contract, as well as within the public-private partnership, in order to obtain income; Capital expenditure - expenses incurred by the investor in

connection with the purchase and / or improvement of long-term assets that are not attributable to the results of the current period but are to be capitalized (attributable to the increase in the value of long-term assets); Foreign investment - an investment made by a foreign investor in the entrepreneurial activity carried out in the Republic of Moldova, including the income from its investment and what is reinvested in the Republic of Moldova; Investment activity - an investment activity and an entrepreneurial activity in connection with same investment in order to obtain income.

In subsequent articles of the law are formulated main forms of investment, principles of protection measures, the order of adjustment of disputes, status of foreign investors, bonds of state power in investment activity.

In order to create favorable conditions for the attraction of FDI to the Moldovan economy, the Government has strengthened the Decision no. 1288 of 09.11.2006 regarding the approval of the Strategy for attracting investments and exports promotion for 2006-2015, published: 24.11.2006 in the Official Gazette nr. 181-183, art. no. 1391 [10].

The main tasks of the Strategy are to increase the investment flow in the national economy (mainly FDI), to modernize and restructure them, to create new competitive, efficient export-oriented production sectors, to reduce the regional structure gaps and to ensure the positive balance of payments. Expanding exports and producing commodities based on investments must be a priority of attracting and applying FDI. The Strategy was planned in two stages. The first stage - the elaboration of the strategic directions for 2006-2010 was determined by the measures of the modern policy of attracting investments, proving them in infrastructure, promoting the management of public property, developing the financial market and stimulating investments; Development of free economic zones and industrial parks. The second phase - the strategic direction for 2010-2015 determines measures to enhance the role of the capital market as an accumulation mechanism and the distribution of accumulations. The results of the Strategy were targeted to the following indicators:

- improve country rating (Moody's, Fitch, S & P);
- investment rules in the economy (share of investments in fixed capital, GDP) 25-30%;
- increase of the volume of investments in fixed capital annually - 8-15%;
- increase in the volume of FDI - no less than 10% year;
- increase of industrial production year - 10-12%;
- accelerate the growth rate of the volume of goods and services exports by 10-15% year.

In the implementation of the Strategy, a special role is reserved for the civil police, which has to operate under the control / supervision of the society and to participate actively in the monitoring process, including the preparation and dissemination of independent information, to include in the political dialogue with the Government and to impose Responding to the effectiveness of the Strategy, fighting for effective policies, sharing responsibility for making specific proposals from society. The main instrument of dynamic and structural FDI analysis is the Balance of Payments and the International

Investment Position of Moldova [11]. The main FDI data are presented in this analysis by 2015 (inclusive). Referring to data for 2016, the NBM only published preliminary data of the Balance of Payments [12]. The main FDI indicators for Moldova are shown in tab. 1.

Table 1. Main FDI indicators in the national economy 2010-2015 (millions USD)

No.	Indicators	Year					
		2010	2011	2012	2013	2014	2015
	A	1	2	3	4	5	6
1.	FDI	2964.45	3261.06	3466.67	3620.97	3613.78	3466.07
2.	Social capital	182.42	1991.79	2140.03	2202.48	2191.08	1957.38
2.1.	Banks	238.28	261.83	247.17	253.08	153.65	202.27
2.2.	Other sectors	1587.14	1729.96	1892.86	1949.40	1937.43	1755.11
3	Reinvested Revenue and Unpaid Profit (+) Losses	349.15	428.88	417.85	437.05	470.12	593.17
3.1.	Banks	46.03	49.93	55.19	64.00	59.54	82.66
3.2.	Other sectors	303.12	378.93	362.66	378.05	410.58	510.51
4.	Other capital (other sectors)	789.88	840.41	908.79	981.44	952.58	915.52
4.1.	Claims against foreign investors	-9.84	-23.05	-32.85	-45.59	-38.66	-27.54
4.2.	Commitments to foreign investors	799.72	863.46	941.64	10627.03	991.24	943.06

Source: Balanța de Plăți și Poziția Investițională a Republicii Moldova, 2016.
www.statistica.md

Data from Table 1 confirms that FDI volume accumulated in the national economy in 2010-2015 increased from 2964.45 million USD to 3466.07 million USD, including:

- the capital share - from 1825.42 million USD to 1997.38 million USD;
- new reinvested earnings and unpaid profit from 349.15 million USD to 593.17 million USD;
- other types of capital - from 789.88 million USD to 915.52 million USD.

Similar changes occurred during this period including in the structure of FDI.

The data are presented in Table 2.

Table 2. Structure of FDI in the national economy 2010-2015, (%)

No.	Indicators	Year					
		2010	2011	2012	2013	2014	2015
	A	1	2	3	4	5	6
1.	FDI	100	100	100	100	100	100
2.	Social capital	61.58	61.08	61.73	60.83	60.63	56.47
3.	Reinvested Income and Unrealized Profit (Loss)	11.78	13.15	12.05	12.07	13.00	17.11
4.	Other capital,%	26.64	25.77	26.22	27.10	26.37	26.42

Source: elaborated by authors, adapted after data from table 1

Within the FDI structure, the share of equity capital fell to 61.58% in 2010 to 56.47% in 2015, the share of reinvested earnings and non-distributed profit (losses) increased from 11.78% to 17.11%, the share of other types of capital during the same period remained intact at 26.40%.

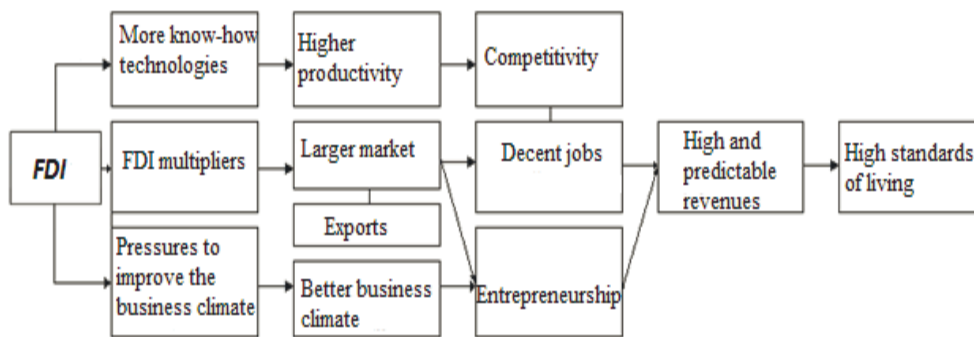
Table 3. FDI dynamics in the national economy, 2010-2015 (mil. USD, %)

No.	Indicators (annual variations)	Year					
		2010	2011	2012	2013	2014	2015
	A	1	2	3	4	5	6
1.	FDI, mil. USD	191.52	296.61	205.61	154.30	-7.19	-147.71
1.1	In % compared to the previous year	6.90	10.00	6.30	4.45	-0.20	-4.09
2.	Social capital	159.33	166.37	148.24	62.45	-11.40	-233.70
2.1.	In % compared to the previous year	9.56	9.11	7.44	2.92	-0.52	-10.67
3	Reinvested Revenue and Unpaid Profit (+) Losses	11.53	79.71	-11.01	19.20	33.07	123.05
3.1.	In % compared to the previous year	4.35	22.83	-2.57	4.59	7.57	26.17
4.	Other capital (other sectors)	17.64	50.53	68.38	72.65	-28.86	-37.06
4.1.	In % compared to the previous year	-2.28	6.40	8.14	7.99	-2.34	-3.89

Source: elaborated by authors, adapted after data from table 1

The example of the countries of Central and Eastern Europe that have more successfully passed the transition phase, even if they have more domestic financial resources and more developed engineering traditions than Moldova, nevertheless rely on foreign investments to achieve a growth and rapid economic modernization. Success in attracting FDI to the initial stages may even generate further FDI, expand access to foreign markets and support growth in exports (Figure 1). FDI also provides access to more technologies and know-how, resulting in a general increase in productivity in the economy. Equally, after overcoming a critical mass, the mere presence of FDI in more developed countries could (not always) contribute to improving the business climate by promoting more advanced business culture elements and more open private-public dialogue. This will lead to more decent jobs and more developed entrepreneurship, especially when SMEs become part of the FDI technology chains. Combining these effects leads to a greater and more stable income, including in terms of raising the standard of living of citizens.

Figure 1. Impact of FDI on the export's volume and living standards of the population



Source: Strategia Națională de Atragere a Investițiilor pentru Dezvoltarea Exporturilor www.particip.gov.md/public/documente/130/ro_2552_Strategia-de-atragere-a-investitiilor-pentru-dezvoltarea-exporturilor-2.0pentru-consultare-16-sept-2015.pdf

The dynamic analysis revealed the following: in total, FDI has diminished significantly with capital inflow of 11.40 million USD in 2014 and 233.70 million USD in 2015. At the same time, there is a substantial increase in reinvested earnings (123.05 million USD in 2015). It is necessary to make an analysis of the banking and real sector. The cumulative data on the banking sector are shown in the Table 4.

Table 4. Dynamics of FDI in the banking sector of the Republic of Moldova in 2010-2015 (million USD, %)

No.	Indicators	2010	2011	2012	2013	2014	2015
	A	1	2	3	4	5	6
1	FDI in the banking sector	284.31	311.76	296.27	317.08	313.19	284.99
1.1.	Annual variations, million USD	11.72	27.45	-15.49	20.81	-3.89	-28.26
1.2.	In % compared to the previous year	9.30	9.65	-4.97	7.02	-1.23	-9.02
2.	Social capital	238.28	261.83	241.17	253.08	253.65	202.27
2.1.	Annual variations, million USD	36.38	23.55	-20.66	11.91	0.57	-51.38
2.2.	In % compared to the previous year	18.02	9.88	-7.89	4.94	0.22	-20.25
3.	Reinvested revenue and unpaid profit (+) losses	46.03	49.93	55.10	64.09	59.59	82.66
3.1.	Annual variations, million USD	-24.66	3.90	5.17	8.90	-4.46	23.12
3.2.	In % compared to the previous year	-34.88	8.47	10.35	16.15	-6.97	38.83

Source: elaborated by authors, adapted after data from table 1

Data analysis in Table 4 reflects relatively stable FDI flows in the banking sector of the Republic of Moldova. The annual report may vary within $\pm 10\%$ that is acceptable for the FDI flow. An important role in stabilizing the activity of the banking sector in Moldova is played by the European Bank for Reconstruction and Development (EBRD). It is the largest institutional investor in the Republic of Moldova that aims to improve transparency and corporate governance in order to facilitate access to credit and investment resources for small and medium enterprises and to improve product quality and service standards [13]. The European Investment Fund concluded a series of partnership agreements with private banks as part of the Moldova InnovFin program for small and medium enterprises, implemented with the financial support of the European Union and aimed at promoting the innovation potential of the country [14]. International cooperation in the near future will stabilize investment flows in the banking sector of the Republic of Moldova. Within the structure of the real sector, FDI of the national economy represent 90-92%. Basic sector data are presented in Table 5.

Table 5. Dynamics of FDI in the real sector (SR) of Moldova's national economy for 2010-2015 (million USD)

No.	Indicators	2010	2011	2012	2013	2014	2015
	A	1	2	3	4	5	6
1	FDI in the SR sector	2680,4	2949,30	3164,31	3303,88	3300,59	3181,14
1.1.	Annual variations, million USD	179,80	269,16	2151	13958	-3,30	-119,45
1.2.	In % compared to the previous year	7,19	10,04	7,29	4,41	-0,10	-3,62
2.	Social capital	1587,14	1729,96	1892,86	1919,40	1973,49	1755,11
2.1.	Annual variations, million USD	122,95	142,82	162,90	56,54	-11,97	-182,32
2.2.	In % compared to the previous year	8,40	9,00	9,42	2,99	-0,61	-9,41
3.	Reinvested Revenue and Unpaid Profit (+) Losses	303,12	378,93	362,66	373,05	410,58	510,51
3.1.	Annual variations, mil USD	39,21	75,81	-16,22	10,39	37,53	99,93
3.2.	In % compared to the previous year	14,86	25,00	-4,29	2,86	10,06	24,34
4.	Another capital	789,88	840,41	908,79	981,44	952,58	985,52
4.1.	Annual variations, mil USD	17,64	50,53	68,38	72,65	-28,86	-37,06
	In % compared to the previous year	2,28	6,40	8,14	8,00	-2,54	-3,89

Source: elaborated by authors, adapted after data from table 1

The analysis of data from Table 5 confirms that in the real sector of the economy the most dramatic changes were noted in the years 2014-2015. During this period, the capital share was reduced by 200 million USD and by 66 million USD the other capital. Due to reinvested earnings, which grew in the period 2014-2015 by 137 million USD, the total decrease in the real sector recorded about 123 million USD.

To improve the situation may serve the program of cooperation between the Moldovan Government and the World Bank within the Strategic partnership for 2014-2017 which provides structural reforms in the investment climate and facilitating access to investment funds [15].

3. Conclusions

The author's view concerning the national governing bodies, that they should establish the priority sectors for attracting FDI, to organize the elaboration of the individual projects, the so-called *investment products*, the formation on their basis of the national market of these products for the investors' offer and their promotion on foreign investment markets.

For the efficient activity in this direction it is proposed the formation of groups by national expert branches for the systemic and objective estimation of each investment project and its social and economic necessity.

Only in such treatment and in the full extend will be reflected the benefits of FDI in the creation of new jobs, mainly in *Greenfield investments*, the development of new industries and branches, the acquisition of new technologies and stimulation of human capital and skills for the new economy.

Besides creating a favorable investment climate in the country, it is necessary to fight corruption, bureaucracy and fraud, which along with other harmful factors alter the image of Moldova, hindering access to foreign investments, demoralizing total society and creating a greater social danger.

One of the major elements on the agenda in the realization of the investment policy of the Republic of Moldova, according to the authors, is the simplification of the investment procedures, which include for investors the transparency of the operative information, the increase of the efficiency and effectiveness of the administrative decisions of the public bodies, the political environment through consultations, exchange of views and negotiations.

Resulting efforts to simplify investment procedures should become indispensable to Moldova's overall investment policy, including regulation, liberalization, protection, incentives and the drive to maximize investment benefits and minimize negative impacts or external factors.

The primary goal of investment policy is to achieve a maximum impact, the investments to serve the interests of sustainable development, using their benefits and minimizing adverse consequences. National decision-makers must find the optimal combination of applied instruments and policies, the balance between liberalization and regulation of investment processes for the sustainable development of the national economy.

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