ARE FOREIGN DIRECT INVESTMENTS AN INSTRUMENT OF SHIFTING THE MOLDAVIAN ECONOMY TO A SUPERIOR LEVEL OF INTERNATIONAL SPECIALISATION?

Author: Dumitru MOLDOVANU*

It is a well known fact that a country or other becomes richer or poorer to a large extent depending on the character of the country's international specialisation. For centuries, the world's countries have permanently changed their specialisation type in order to obtain higher incomes and become more prosperous.

From the theoretical viewpoint, currently, under the conditions of globalisation, the countries of the world may change their type of specialisation under the influence of foreign capital investments. It is indeed true, and yet, the opinion that FDI any time and anywhere, under any circumstances are beneficial to the host country is somewhat exaggerated. In the vast majority of cases, FDIs "pull" the host country towards progress, and in some cases, these still can change a formerly prosperous country into a simple exporter of raw materials.

We expect that FDI shall make us richer, shall increase the economic development level of the country. We are still expecting it today, even if with less enthusiasm. Why?

Key words: *foreign direct investments, international specialisation*

JEL Classifications: *F0; F1; F4*

The current level of specialisation of the Moldavian economy

Currently, the economy of the Moldavian Republic faces the following important issues:

1. The massive exodus of the population abroad. Despite the yearly increasing level of GDP and wages between the years 2000-2006, the number of jobs in the economy continued to decrease.
2. The increase, as of 1994, of the trade balance deficit, which was in the year 2006 of almost 1.700 millions $.
3. The insufficient investment level, including the one of direct foreign investments in the real sector of economy.
4. The low level of specialisation of the Moldavian economy, resulting from its de-industrialisation, which determines the unstable, fluctuating character of the economic development, and which generates very low incomes.

The analysis of the evolution of the foreign trade structure of the Republic of Moldova in the last decade shows that the Moldavian economy is at an inferior level of international

** Prof. Dumitru MOLDOVAN, Ph. D. in Economics, Associated Member of the Moldavian Academy of Sciences; e-mail: dumold@ase.md.*

specialisation, a level which basically meets the first two stages of the international specialisation (from the six identified by the economic science).

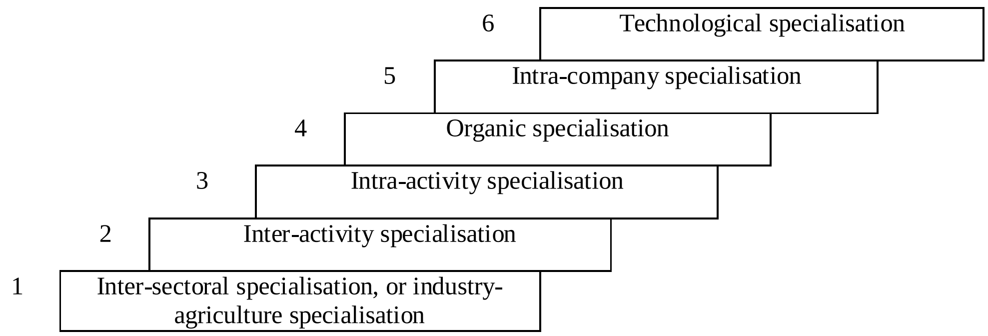

Figure 1 - Evolution of the international specialisation forms in the countries of the world

It is true, next to the wares of agricultural origin, our country also exports some manufacturing products, but their share in the structure of the Moldavian structure for the years 2000–2006 is insignificant. In this period, about 30-35% of total Moldavian export were represented by “food products, beverages and tobacco”; over 18% textiles; 12% vegetal products, and 4 to 6% gross leather products, processed leather and furs. In this manner, about 60% from all exported wares are food products and a large part thereof were exported under the form of raw materials – wine in barrels, unfermented tobacco, unprocessed vegetables and fruits, etc. We would like to remind here that at the beginning of the 21st century, manufactured goods represent more than three-quarters of the total volume of world trade, and raw materials and food products represent 4%, respectively 6% from this volume.

Table 1

Export structure for material goods in the years 2000-2005 (in % from total)

	World exports	Export of the Moldavian Republic
Manufactured goods	80	34
Food products, raw materials, mineral products	20	66

Source: own calculations of the author.

The data from Table 1 indicate that currently the Moldavian economy is still preponderantly agricultural and exploiting essentially the comparative advantages generated by the favourable natural conditions, such as fertile land and mild climate. The textile and clothing exports have as basis the intensive use of the cheap and relatively qualified labour force. In this activity the labour productivity is the same as in Italy and France, yet wages are ten to twelve times lower.

The necessity of shifting to a superior type of international specialisation

Looking for high advantages and profits, the most advanced countries of the world have specialised and re-specialised ceaselessly for more than two centuries now, shifting slowly from the simple types of international specialisation to newer and more sophisticated forms that bring higher incomes.

Within the contemporary world economy, the profitability rate in the activities of the traditional industry (metal industry, textiles, chemical industry, and even machine building industry) is much lower than in the so-called activities such as services and, especially, the "production" of new scientific knowledge – patents, investments, and advanced technologies. This is the reason why developed countries gradually shift the capacities of the traditional industry (metal industry, chemicals, textiles) towards developing countries.

In order to become more efficient and generate more incomes, the Moldavian economy must shift to a higher threshold of international specialisation, in our opinion, the organic one which consists in the specialisation of world countries in the manufacturing of finished goods, but especially of their spare parts, of details, semi-fabricates, and aggregates.

During one decade and half of reforms and changes, in the Moldavian Republic no official strategy was yet developed for re-specialising the Moldavian economy in accordance with the new advantages obtained by our country with the proclamation of independence, or this proves to be a stringent necessity.

Comparative and competitive advantages of the Moldavian economy

The first step in drafting the re-specialisation technology of the Moldavian Republic is the identification of the new comparative but also competitive advantages that the Moldavian economy gained after the collapse of the USSR, the opening to the exterior and the sudden increase of prices of energy and raw materials.

The current comparative advantages of our country seem to be less than in the Soviet period, but these could also be more efficiently put to good use. These advantages are:

1) The skilled and cheap labour force which would be motivated to return from abroad. This labour force could turn into the main factor for attracting foreign direct investments and for manufacturing competitive wares (products of the information technologies, textiles, spare parts and components for the machine building industry and for the electronic industry, etc.). Even if according to the GDP per capita Moldavia got one of the last places in Europe, according to the development level of the training system of the population the country is close to the European average. By and large, according to the criterion of the population's training and skills, the Moldavian Republic is on the positions 45-55 in the world, being far better placed at this indicator than many European countries.

It is well known that each nation is better skilled in one or another field of activity. Hence, it is considered that the English are the strongest with respect to financial businesses (financial engineering), Germans in organising production, Slav nations in launching some fundamental concepts and Latin nations in drawing shapes, design. Moldavians seem to be talented in creating new shapes but especially in studying mathematics and information science and in generating computer programmes, software.

2) The fertile lands and mild climate allowing for the development of an efficient agriculture, of clean ecological goods, of high quality wines, as well as of plants used as raw materials for generating energy resources (rapeseed, corn, sugar), represent an advantage but an advantage allowing currently only for our survival. Countries counting only on this advantage remained poor.

3) The existence of favourable conditions for the development of construction materials manufacturing (important clay, lime, sand and gravel deposits, etc.) and of alternative sources of energy.

4) The geographic positions as connection “bridge” between East and West, enhanced by the knowledge of foreign languages – especially Russian, English and French – by the majority of the population, along with the tradition and inborn skills in studying mathematics and information science.

Even if we count on a series of advantages, comparative to other countries, we must take into account that these are to a large extent only temporary, and failure to put them to good use in time, shall lead to their disappearance or to their diminished significance. Hence, the advantage held by the Moldavian economy in the first years of transition partially vanished – the cheap and highly skilled labour force in electronics and information technologies, etc. If this advantage continues to diminish, the Moldavian economy shall not succeed in valuing its other advantages.

Preconditions of Moldavia’s economy re-specialisation

Re-specialisation presupposes, firstly, the development of those industry activities in which we have certain advantages, that is: food industry, constructions’ materials industry, the labour force highly intensive industries such as textiles and electronics.

Because currently specialisation of an economy is dependent on the potential outlet markets, the main precondition of specialisation for the Moldavian economy is adhering to a regional economic organisation with a stable and vast outlet market which, in the case of our country, could be only the European Union. The Moldavian Republic has some advantages also on the CIS market, but these are different from the ones held on the market of the EU countries. Thus, by its orientation towards the CIS we lose our main comparative advantage – the cheap and skilled labour force, because this is one advantage shared with the other countries from the former Soviet area.

The second precondition of specialisation for the Moldavian economy is to put an end to the massive exodus of labour force abroad. A significant increase of nominal wages concomitantly with the price increase would diminish the number of those leaving to work abroad.

Instruments of shifting to a superior type of international specialisation

The mechanisms of shifting from one type of specialisation to another, a superior one, were changed along the centuries. Thus, if two centuries ago the shift from agriculture to industry was made haphazardly based on the invisible market forces, in the 20th century the international specialisation was the product of a conscientious economic policy, promoted by the governments of several states, or by large private companies which, with the purpose of maximising their profits, adjusted far quicker to the requirements of the market. The shift in the type of specialisation of a country based on a particular strategy is the case of the socialist countries that used for this purpose an efficient mechanism, which is planning. Based on an economic policy consistent in using state subventions for shifting to another type of specialisation the following countries also switched to other types of specialisation: Japan, Germany, South Korea and Hong-Kong, and partially China and Turkey, etc.

Under the conditions of globalisation a special importance gain the FDI flows, which could serve as re-specialisation instrument for the countries of the world.

Foreign investors, by investing in one or other country, pursue, firstly, to obtain higher incomes than in the origin country of the capital. This is for the benefit of the foreign entrepreneurs. But which is the interest of the countries allowing for FDI on their national territory? The renewed endowment of their enterprises, a modern management? Much too less, because the price paid in the case of allowing for FDI (diminution of the economic independence of the country, loss of incomes which go abroad, increased level of unemployment, etc.) is too high. Generally, FDI are justified when these change the type of international specialisation of the country by gradually shifting to a superior one, which brings higher profits. Yet, when FDI change the country into a simple producer of raw materials, their impact on the future of the country is far more negative than positive.

If FDI play either a positive or negative role in the development of a country depends only on the economic policy promoted by one or the other country.

The possibility of using FDI for the national interests is given, but we must make use of this opportunity. Therefore, the country should draft differentiated policies in attracting foreign direct investments, combining them with the temporary protection of the fields of activity in which the country intends to specialise.

The changes occurred in the behaviour of transnational companies which transfer considerable production capacities in other countries to the largest extent for producing goods for their own internal market, respectively for the origin country of the capital, substantially alter the opportunities and fields of specialisation for the countries of the world as these are already re-specialised depending on the particular interests of the trans-national capital. These interests might coincide with the national interests of the respective country if the Government of the country is skilled enough and manages to attract foreign investment specifically for those branches and fields of activity in which the country intends and can be specialised.

Up to now, FDI have not played a significant role in the economy of the Moldavian Republic, they representing in the years 2000-2006 only about 11% to 15% from the total volume of investments in fixed capital, even if during the last decade and a half the FDI stock has been constantly on increase.

Table 2

Evolution of the FDI stock within the economy of the Moldavian Republic (at the end of the year in mill. $)

1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
7	19	21	25	47	113	146	193	310	440	536	675	755	902	1000	1300

From the above table it can be seen that the annual FDI flow was on increase, for about 5 to 7 millions USD annually in the years 1991-1994, up to 225 millions in 2005 and 280 millions USD in 2006. Nevertheless, the FDI stock in the Moldavian economy remains rather modest.

The FDI volume per capita in Moldavia is one of the lowest in Europe. Thus, by the end of the year 2005, the FDI volume per capita was only 333 $, whereas in the Czech Republic it was 4080 $, in Hungary 3693 $, Estonia – 2995 $, Poland - 1502 $, and Romania - 747 $. At the same time, the enterprises with foreign capital from the Republic of Moldova employ only 5% from the total number of employees. These enterprises achieved only about 15% from total sales. Hence, in Moldavia entered FDI which make use only to a small extent of the main advantages of the Moldavian economy – the cheap and skilled labour force, and the favourable conditions for developing the agri-food industry.

Foreign investments in Moldova used up to now the monopoly situations which allowed for obtaining high profits due to the high prices and tariffs for delivered services. This refers to important investors within the national economy such as Gazprom (control package at Moldova-Gaz), Union Fenosa, Voxtel, Moldcell, Lafarge, the supermarkets for wholesale trade, etc. An exception is only with respect to textile industry enterprises and the ones of processing the agricultural output.

Table 3

Structure by groups of goods of FDI in the Moldavian Republic economy (in % from total volume)

Ord. no.	Groups of goods	1.01.1997	1.01.2004	1.01.2005	1.01.2006
1	Electric energy, gas and water	3	33	32.4	35
2	Manufacturing industry	25	24	25.4	27
3	Wholesale and retail trade	30	18	16.7	16
4	Financial activities	14	10	8	6
5	Transport and communications	3	3	5.3	7
6	Agriculture	1.7	3	9.9	7
7	Hotels, restaurants	5	9	5.3	12

Source: National Statistics Office.

In the above table we notice that the main issue of FDI in Moldavia is their modest volume, also their structure by activity, a structure which contributes to a very small extent to the development of the Moldavian economy, but mainly to changing the type of international specialisation of our country.

The analysis of the activity conditions for FDI and of activity structure for the aforementioned shows that our state did not establish some priorities in this regard. Unfortunately, these priorities weren’t identified in the “Strategy for attracting investments and promoting exports in the years 2006-1015” which was approved by Governmental Resolution on 9 November, 2006.

In our opinion it is necessary for foreign enterprises investing in the fields in which the Moldavian Republic intends to specialise (electronic industry, agri-food industry, textiles, construction materials, activities of software development, car assembly, infrastructure and agriculture development, etc.), and in the sectors that would allow for exports’ substitution (alternative sources of energy, first of all) should benefit of the best fiscal, administrative facilities, and of any other kind. These enterprises should be granted fiscal facilities for imports, for instance, the possibility of paying VAT and other customs duties for a period of time when their profits show stability. At the same time, the state could grant them certain subventions, monetary ones, credits at low interest rates, or ensuring state purchases.

Very often, foreign investments in wholesale and retail trade, or in building houses damage the background for developing small business in Moldavia and contribute to unemployment increase. Moreover, foreign supermarkets promote import products on the domestic market, including food products. These enterprises, as well as those from other fields, including constructions and even telecommunications do not put to good use the competitive and comparative advantages of the Moldavian economy, but only collect the money gained by our co-nationals abroad, and thereafter, this money leaves the country under the form of “fat” profits. Then, what is left after such foreign investments?

Commercial policy

Another efficient instrument in ensuring the re-specialisation of the Moldavian economy might be the commercial policy. Within some scientific and political spheres, there still persists the wrong belief that small economies should promote a major openness policy towards the external environment, and to have a liberal commercial regime, and this policy is regarded as the guarantee of sustained economic growth. It is indeed true, but it is a truth referring to well established economies and not to transition economies which still try to identify their place and intend to change their specialisation type. An over-liberal commercial regime, even if it has some positive consequences on creating a competitive business environment, proved to be less efficient, even dangerous, for developing economies, such as is the case with the Moldavian Republic.

It is obvious that the liberalisation of foreign trade was a necessary reform, which contributed to creating an economy based on competitiveness, and to the integration of our country into the world economy. But, we consider that things have gone too far. Nowadays, according to the classification of the International Monetary Fund, the commercial regime of the Moldavian Republic is the “first” (most liberal). A country such as France did not liberalise all activities of the economy, protecting even today by using high customs taxes agriculture and textile industry. Yet, Moldavia had another approach. Consequently, by applying for more than a decade and half of independence “the most liberal possible commercial regime”, our country could not identify its own international specialisation and comparatively to other European countries became poorer and poorer and much less developed.

The negative effects of the excessive liberalisation of imports are:

a) The constant increasing trend of the foreign trade deficit as of 1994. In the last years this trend became even more marked.

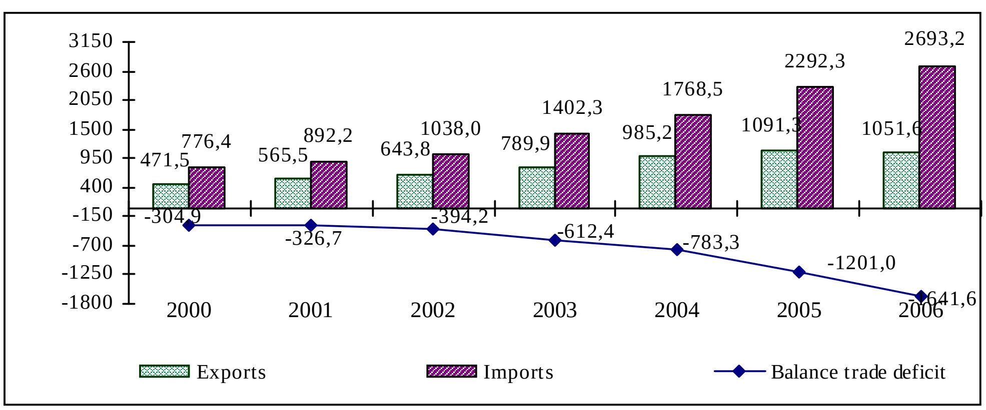

Figure 2 - Trends of Moldavian foreign trade
(in the years 2000-2006, mill. USD)

b) In the years 1991–2000, the Moldavian Republic was placed on the first position with respect to such an indicator as the "diminution in the GDP during a decade". In this period the Moldavian GDP decreased by -8.5% annually. On the second place was Georgia – 8.2%, followed by Tajikistan -7.6%, Ukraine -6.6%, Congo -5,4%, and Sierra Leone -3,7%. In 2000, the Moldavian GDP represented only about 35% of that in the year 1990.

In this way, during a decade the liberal commercial regime of the Moldavian Republic did not ensure either economic growth, nor did it contribute substantially to shifting to a superior type of specialisation. As result, the competitiveness of traditional Moldavian goods continues to decrease, which indicates also the diminishing degree of export diversification. Thus, if in the year 1998 there were exported goods within 1000 tariff categories, in 2005 this indicator diminished to only about 700 categories of goods. Moreover, in these years, about 95% of the exports were ensured by only 15 categories of goods.

Even in 2006 the Moldavian GDP represented only 48% from its level in the year 1991. By having a competitive economy, our country could have only but gained from a liberal commercial regime. But when from the 117 monitored countries with respect to the indicator "global competitiveness", the Moldavian Republic is on the positions 82-86, excessive liberalization is not most adequate for the situation.

The present commercial regime is suitable mostly for the economic interests of other countries, not of Moldavia, and for some very influent importers and imposes to the state authorities a passive and less creative behaviour. Moreover, it does not allow for the development of the activities in which we have certain comparative advantages and increases the exodus of labour force abroad. And, along with the labour force also the "opportunities" of shifting to another higher type of specialization desert us.

Already at the beginning of the 1990s the imports left to chance were one of the main reasons for the collapse of the Moldavian industry. This policy changed the Moldavian Republic into an outlet market for consumer goods of a rather suspect quality very often and oriented in a wrong direction the use of population's incomes.

In our opinion, import should be only a source for obtaining high profits and for ensuring in the country products that were lacking. Import should become an efficient instrument in reaching some strategic objectives of first order, such as international re-specialisation of the economy in accordance with the available advantages. In considering the countries of Central and Eastern Europe (including here the Moldavian Republic) the French economist Regis Chavigny mentioned at the middle of the nineties of the 20th century that "mediocre specialisation of these countries in exporting mainly raw materials and food products (a situation which cannot be by any means satisfactory to them, as they do not intend to change into an agricultural periphery of the West) "compels" Eastern Europe to make use of a certain type of educational protectionism simultaneously with the liberalisation of their foreign trade".

Hence, in the case of developing countries and transition countries, import should not be only a means of covering the goods demand for those goods that the respective country cannot produce, but also an instrument for shifting to a superior type of specialisation.

Table 4

Evolution of import structure in the years 1991-2006
(main categories of imported goods in %)

		1992	1997	2000	2002	2003	2004	2005	2006
1	Mineral products	42	35.3	33	22.8	22.4	22	22	24.6
2	Machinery, devices, electric equipment and components	8	13	13	14	16	13.5	13.6	14
3	Products of chemical industry and of related industries	4.4	10	10	11	10.4	9	10	8.3
4	Common metals and articles thereof	6	4.4	4	5	4	6.2	7	8
5	Textile materials and articles thereof	10	10	10	9.3	10	8.5	7.8	7.6
6	Food, beverages, tobacco	23	7.5	9.2	7	8	6	6.5	6.7

Source: Own calculations after the data of the National Statistics Office.

In the structure of the Moldavian imports the share of the goods under the category "machinery and devices, electric equipment and components: even on increase for the last years, it still represents only 13-14% of the total volume of imports. For a country like ours, this is a much too low figure. In some countries in transition, which insistently act in this direction, the share of machinery, devices and equipment in the import volume is 25-30%, and in some cases even more.

In the year 2006, the Moldavian Republic has imported goods under the category "food products, beverages with and without alcohol, tobacco" with a value of 180 million USD. It is a much too high amount for a country where we have comparative advantages specifically related to this category of products. In Moldova customs duties are very low, as they represent 0-15% of the value of the goods in customs. The simple average of the Moldavian customs tariff is 6% (for agricultural products it is 12.6%, for the industrial ones 4%). At the same time, in the EU the average of customs tariffs for agricultural goods is 20%. Why should our country not increase the customs duties for products in which we specialise, that is agricultural and textile goods, some electronic goods, stone, plaster, cement, ceramics, glass and similar materials up to 25-30%? Why should we not apply the multiple non-tariff instruments to protect the domestic market in the fields in which Moldavia intends to specialise? By these tariff and non-tariff instruments the state has the opportunity to protect the domestic market and to stimulate the demand for goods manufactured in fields in which the country intends to specialise.

This purpose should also be served by the export policy, which is limiting to minimum the export of raw materials, especially with respect to agricultural products exported abroad. In Moldavia there are no taxes whatsoever for the export of raw materials and this does not serve the national interest. If these were in place, our country could export manufactured food products and raw materials changing also from this perspective the specialisation type. Together with the raw material also the opportunity of enriching the country leaves abroad. The most competitive product of "export" for Moldavia is the labour force. This export can be justified only if it has a temporary character, and remittances are used for developing the domestic business.

Foreign trade is the gate through which a country usually obtains prosperity and in some cases, yet seldom, poverty might come to the country. For centuries defending the domestic market was one of the main functions of the state. This function is very important in the contemporary world. It is true, this function is more and more fulfilled nowadays within some regional economic organisations such as EU, CIS. ASEAN, etc.

References

Kornaj, J., Du socialism au capitalisme. L'Exemple de la Hongrie, paris, 1900.

Moldovanu, D., "Economia Moldovei în capcana globalizării şi tranziţiei. Arc, Chişinău, 2004.

Moldovanu, D., "Tranziţia: interdependenţa transformărilor sistemice şi a integrării în economia mondială", ASEM, Chişinău, 1997.

Stiglitz, J.E., "La grande désilusion", Fayard, Paris, 2002.

*** "Republica Moldova - Breviar Statistic", 1997-2003, Chişinău, 1998, 2004.