

FDI attraction in 2015 – not bad, for a bad year

Despite the turbulent economic and political developments in Moldova, FDI inflows in 2015 are estimated to have reached the highest value since 2011. Especially for automotive suppliers Moldova remains an attractive location. This is even more surprising as anecdotal evidence suggests that the business climate has rather worsened than improved over the last years, with existing investors complaining about increasing abusive behaviour from state bodies. Against this backdrop the recently announced moratorium on control from state bodies may be welcomed by existing investors. Now the government needs to prove that this is part of an earnest reform to improve the business climate as opposed to mere party politics. Clearly, there is much room increasing FDI inflows further.

Difficult economic and political backdrop

2015 was a difficult year for the Republic of Moldova marked by economic and political instability following the bank fraud scandal. Two short-lived governments were appointed in 2015, including a minority one, with each lasting for only about one hundred days. In addition, the fall out of the bank fraud contributed to an already difficult economic environment which led to the devaluation of the national currency and the need to tighten monetary policy to stabilise the economy. Real GDP is expected to have contracted by 1.8% in 2015 according to the IMF's latest report - although recent data suggest the decline may be less pronounced.

FDI development

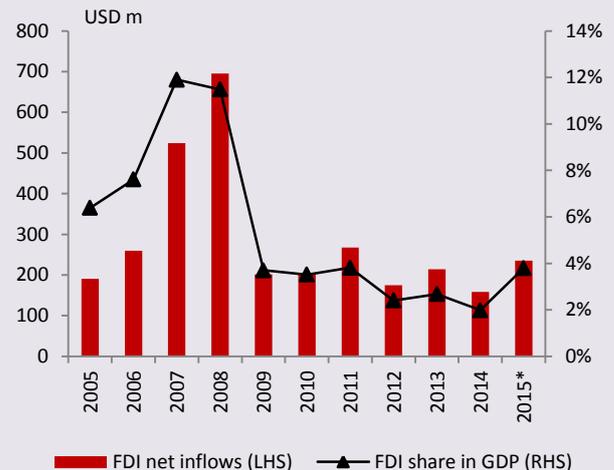
Against this backdrop, foreign direct investment (FDI) held up surprisingly well. Until September 2015, FDI inflows reached around USD 180 m, a significant increase from USD 158 m for the whole of 2014. If this trend is continued, FDI inflows are likely to have reached around USD 230 m in 2015. This would bring FDI inflows in comparison to GDP to a ratio of 3.8% in 2015 – marking the highest value since 2011. However, it also reflects that nominal GDP in US dollar terms has fallen by nearly a quarter due to the recent devaluation. Nevertheless, there is no denying that FDI came in stronger than expected during the previous year.

Success stories

The automotive sector remains of particular interest to foreign investors. This is underlined by the decision of Sumitomo Electric Bordnetze to start production in Moldova with plans to employ between 3,000 and

4,000 people once the investment is completed. Production will be set up in a greenfield project in Orhei, where the parliament approved a new Free Economic Sub-Zone.

FDI inflows



Sources: IMF, National Bank of Moldova

*2015 estimated based on data until September 2015

Confezioni Andrea, a producer of textile car covers which set up shop in Soroca already in 2014, plans further investments in Moldova. The company plans to increase employment to 2,500 people, following an initial plan to employ around 1,500 staff.

Triveneta Cavi, a cable producer, is another project which took off in 2015. The company's investment in 2015, which took place in partnership with the EBRD, amounted to nearly EUR 10 m. Once finalised, the company plans to invest a total of EUR 25 m and to employ around one hundred people.

Dräxlmaier, a German producer of wiring harness systems active in Moldova since 2007, just announced its plan to extend operations by investing around USD 30 m and adding around 2,500 jobs.

Challenges for existing and new investors

Surprisingly, the positive FDI development happened at a time when especially local small and medium sized enterprises signalled an increasing number of abuses from control bodies. Specifically, an increase in dubious actions is said to have come from the police and the anti-corruption centre. No names were given, but a few different associations mentioned it during a meeting of the Prime Minister's Economic Council.

Additionally, a few cases were reported in the press about disputes between companies and the Ministry

of Environment on several issues. Gebauer&Griller, for example, was prohibited to export scrap metal, despite previous authorisation by the same ministry. While most issues could be settled, some damage to Moldova as an investment location will have occurred.

Furthermore, there is slow progress in investigating the USD 1 m damage caused to the country's National Bureau of Insurers as well as several other frauds in the insurance sector. This led to an earlier decision by the Council of Bureau to exclude Moldova from the green-card insurance system and signals a problematic business environment in the insurance sector.

Business climate outlook for 2016

While the political situation in Moldova has calmed down for now, the forthcoming presidential election in March this year could lead to more turbulence in the political sphere. However, if the current government remains stable for a prolonged period of time, some positive changes for investors may be expected. Indeed, the new Prime Minister, Pavel Filip, has announced a number of measures which aim at improving the general business climate. One of his first actions was to enact a three months long moratorium on controls by the Tax Authority, the Customs Service and the Economic Police. Meanwhile, the prime minister's office plans a structural reform of controlling bodies and ministries. The appointment of Octavian Calmac, who was the chief negotiator for the DCFTA, to the post of deputy prime-minister and minister of economy, is also meant to signal that the government means business in terms of DCFTA implementation.

Conclusions

The government needs to focus now on restoring economic stability by stabilising the banks and agreeing on an IMF programme. If the government is genuinely interested in increasing bank shareholder transparency and accountability, it should open wide the doors for subsidiaries of foreign banks, which could bring some healthy competition and business practices to the sector.

In addition, the government should make a clear assessment of where the country currently stands in foreign investors' preferences. This review should assess the business climate and whether existing preferences are sufficient. However, any type of state-aid needs to undergo a rigorous cost-benefit assessment. With the fiscal situation as precarious as it is, measures towards improving the investment climate could prove a cost-effective alternative to further fiscal measures.

If the announced reform of ministries and state bodies is indeed carried out properly, this could go a long way in improving the business climate. However, it remains to be proven by the new government that the changes in the state institutions are more than merely an exchange of persons to those with the "right" party membership.

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Note: This text is the sole responsibility of the author and does not necessarily reflect the opinion of the German Economic Team.

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