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Foreign direct investments in economy of Republic of Moldova and perspectives for their grow in the framework of neighboring with EU

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INTRODUCTION

Similar to other countries in the region, at the beginning of the 90s, Republic of Moldova had to face new economic conditions. One of the distinctive features of the South-Eastern Europe and CIS countries was the start of their transition without any foreign investment, hoping on existent resources for financing the economy. After 15 years of transition, the development level of these countries is very different. During this period there was progress registered in terms of attracting foreign direct investment: from 50 USD per capita in Uzbekistan to 5000 USD per capita in Croatia. The analysis of the economic performance indicators of these countries during this period, shows a positive correlation between FDI inflows and national economic competitiveness. Unfortunately, Republic of Moldova does not have strong achievements in this concern. It placed among 5 last countries in the region according to the size of FDI per capita.

The failure to draw foreign investments in the national economy in the beginning of the transition period is due to lack of natural resources as well as inadequate policies or even lack of such policies which would regulate the FDI issues. As a consequence, Moldova missed the first wave of privatization which brought significant FDI resources to countries in the region. Unfortunately even after the society and the Government understood the importance of the foreign investments in the transition economy and the need for specific measures to improve the investment climate in the region, Moldova does not receive massive capital inflow compared to neighbor countries. This can be explained by previous failures which tarnished country's image and competition among other countries for attracting foreign capital.

The growth of foreign direct investments since 2004 is a positive factor. Moreover, since the country neighbors EU, today it has the possibility to draw significant foreign investments coming from this region. However, the only status of EU neighbor will not contribute to attracting these investments. It is necessary to improve the image for investors, create a favorable business climate and stimulate the investors, so they can choose Republic of Moldova as a destination country for their capital.

The purpose of the „Foreign direct investments in the economy of Republic of Moldova and their growth perspectives in the framework of neighboring with EU” study is to track the evolution of the foreign direct investments made in the national economy from the beginning of the transition period to present days. The study reflects an analysis of the policies and factors which had a positive and/or negative impact on foreign direct investments, made in the country. This will contribute to formulating the recommendations for improving the investment climate of Republic of Moldova in order to benefit from neighboring with EU and capital flows coming from member countries.

The research is structured in two chapters. Chapter I – „Evolution of foreign direct investments made in economy of Republic of Moldova” – comprises an analysis of FDI made during 1992 – 2007 and their structure. In order to outline their importance for transition countries Republic of Moldova was compared with countries of the South-Eastern Europe and CIS. The outcome is the correlation between foreign direct investments and economic competitiveness. This chapter also includes the SWOT analysis of the FDIs made in Republic of Moldova, in order to understand the

connection between low investments made in Moldova and the business environment of the country.

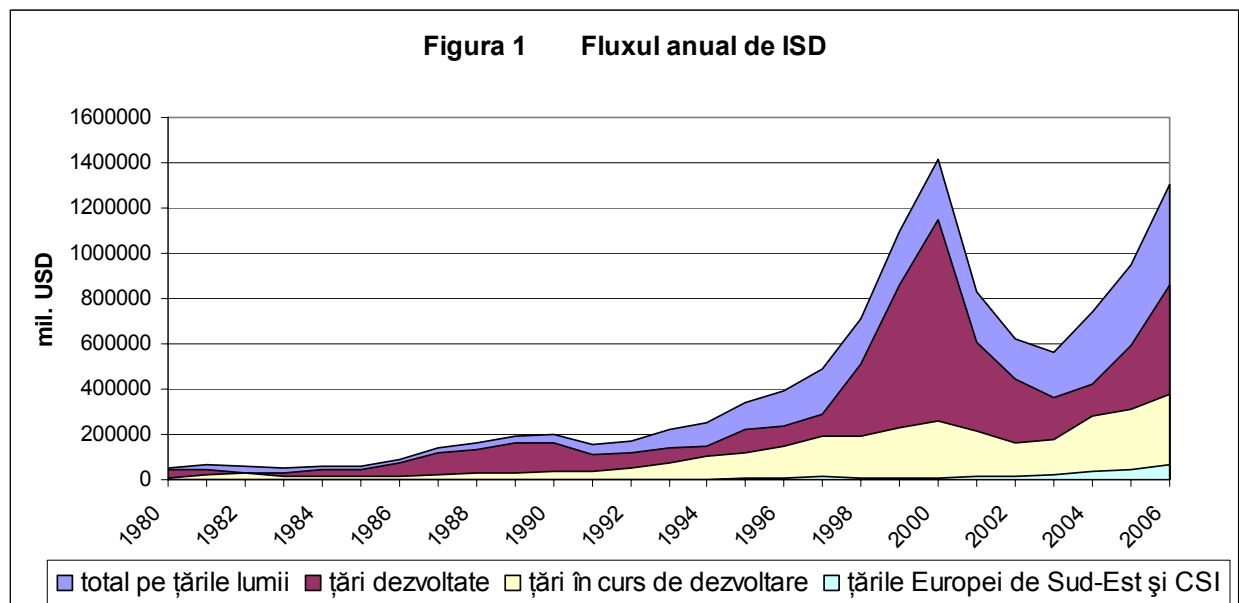
The detailed analysis of the government policies and the causes for poor performance related to foreign direct investment are described in Chapter II – „Policies and Strategies for attraction of foreign direct investment in Republic of Moldova”. In this chapter major problems are identified and solutions are proposed for creating favorable investment climate. The study ends with a series of conclusions and recommendations.

CHAPTER I

EVOLUTION OF FOREIGN DIRECT INVESTMENTS MADE IN MOLDOVA

1.1. Republic of Moldova as a destination country for Foreign Direct Investments in the context of South-Eastern European and CIS regions

The fall of the communist system and Soviet Union at the end of 80s-beginning of 90s caused several new independent states to appear on the world map which were similar at that moment from the economic point of view. The 15 newly independent states together with countries from the South Eastern Europe started their transition without or extremely small foreign investments in their economies. After 15 years of transition, situation changed significantly. During this period global foreign investments increased and their geographic destination started to change. Thus, in 2006, South Eastern European and CIS countries received 5,3% from the general amount of foreign investments compared to 0,04% in 1990 (Figure 1).



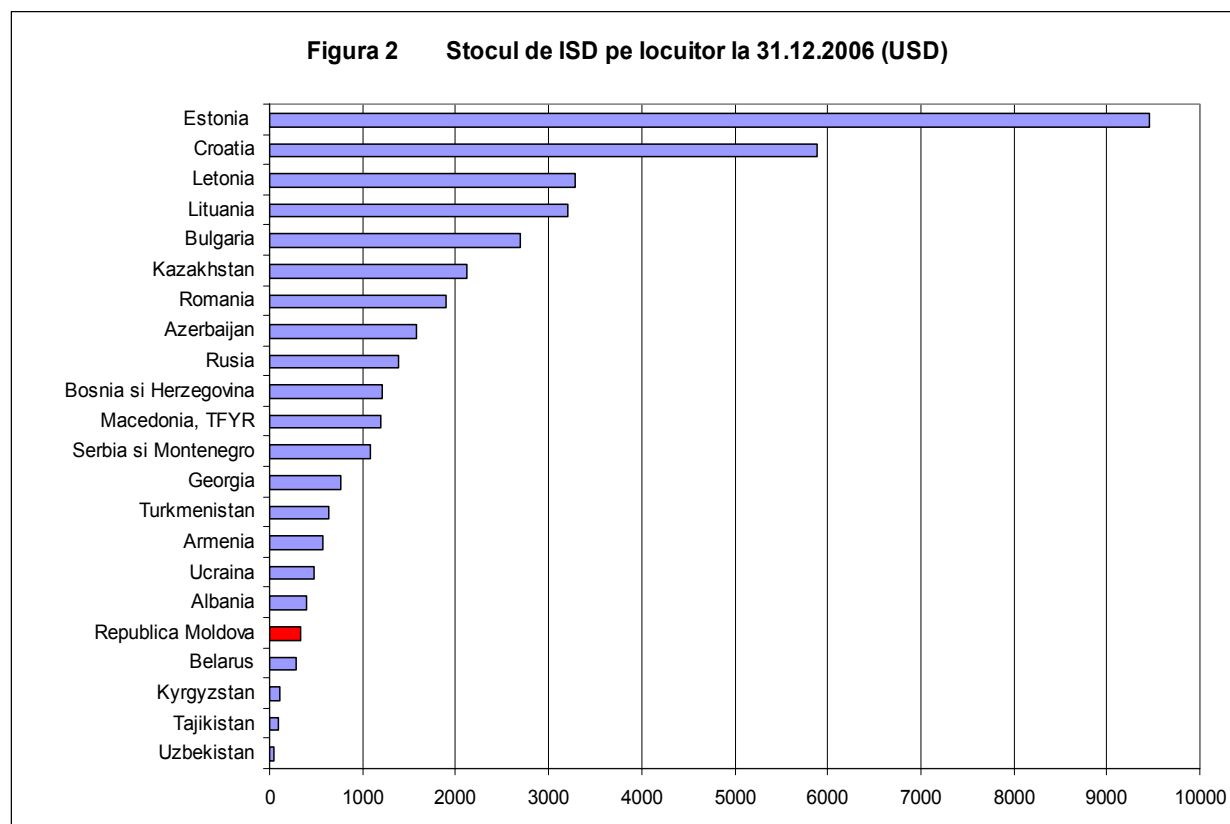
Source: UNCTAD Foreign Investment Database

However, the progress for attracting foreign direct investments is different from one country to another. According to the UNCTAD¹, „World Investment Report 2007”, almost 82% of the regional foreign direct investments were made in 5 countries: Russian Federation, Romania, Kazakhstan, Ukraine, and Bulgaria. Privatization which took place in different regions had a major contribution to attracting FDIs in these countries. This process was much rapid and transparent in South Eastern Europe. The outcome of this was greater foreign investments in this region than in CIS. An important factor for attracting foreign investments in CIS was natural resources. The main destination which investors were aiming was Russia, Kazakhstan and Azerbaijan. Republic of Moldova did not benefit from these investments and was one of the least attractive countries for foreign investors. In 2006 Moldova placed among the last 5 countries in

¹ United Nation Conference on Trade and Development

the region according to the volume of foreign investments per capita (Figure 2), being even among the last European countries, outrunning only Belarus.

(The volume of FDI per capita as of 31.12.2006 (USD))



Source: UNCTAD Foreign Investment Database

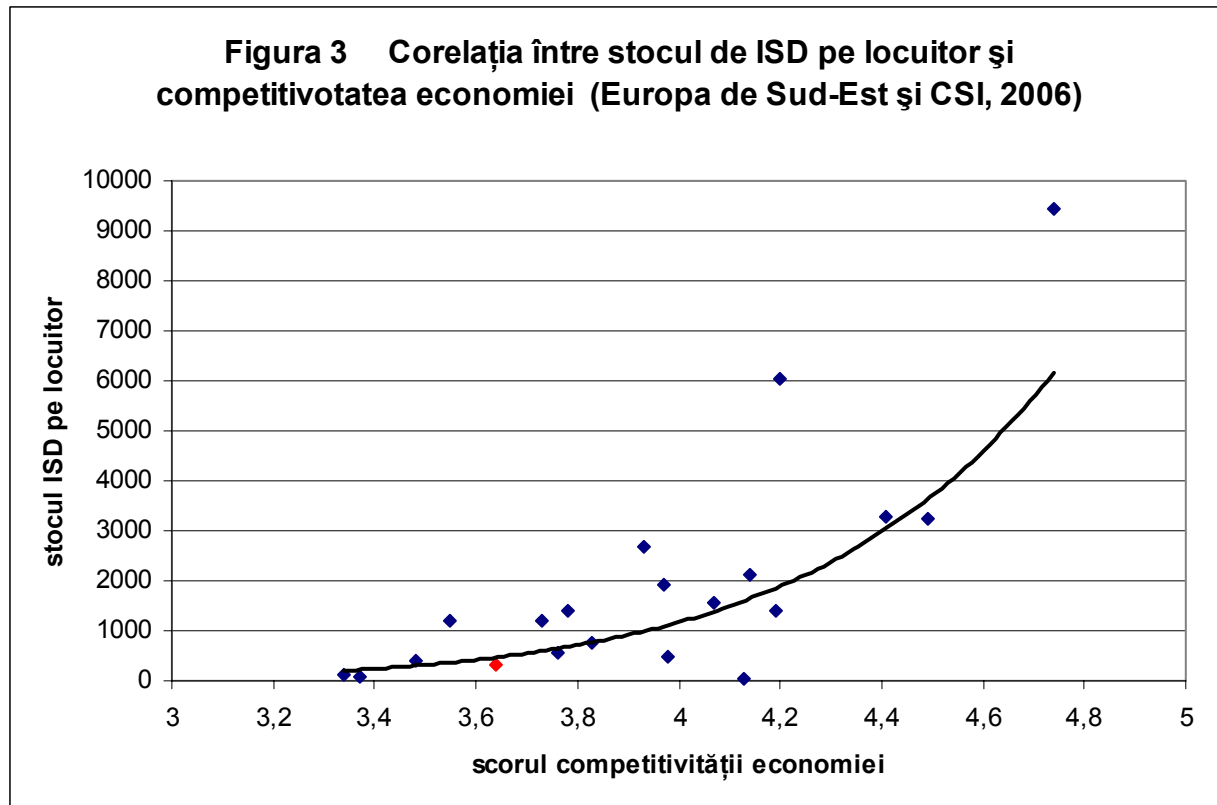
The Baltic countries were included for comparison

The insignificant volume of foreign investments in Republic of Moldova is one of the obvious reasons for having a difficult social and economic situation. The foreign investments have a positive impact on country's development when lacking own financial resources for making investments. In this context, there exists a positive correlation between the amount of investments per capita and competitiveness of national economy (Figure 3). This is the main reason why countries compete for attracting foreign investments. The period when investors were looking to place capital and countries were receiving or not these placements is over. Today countries apply different methods for attracting foreign capital, by offering various advantages to foreign investors. Even though it did not always contribute to attract significant foreign investments, this competition helped several transition countries to make reforms and improve the legislation regulating entrepreneurship and create a favorable business climate. Therefore, the foreign direct investments made a certain country indicate the level of development and degree of credibility of this state.

Figure 3: The correlation between the FDI per capita and the economic competitiveness (South-Eastern Europe and CIS, 2006)

FDI stock per capita

Figures of economic competitiveness



Source: The author has calculated the correlation based on the UNCTAD and Global Competitiveness Report data.

Many countries make great efforts to attract foreign investments not having own financial resources and advantages that the direct foreign investments offer:

- Access to new technologies
- New jobs, especially when investments are made in "Greenfield" projects
- Development of new economic sectors
- Development of human capital
- Support to local companies to access new export markets.

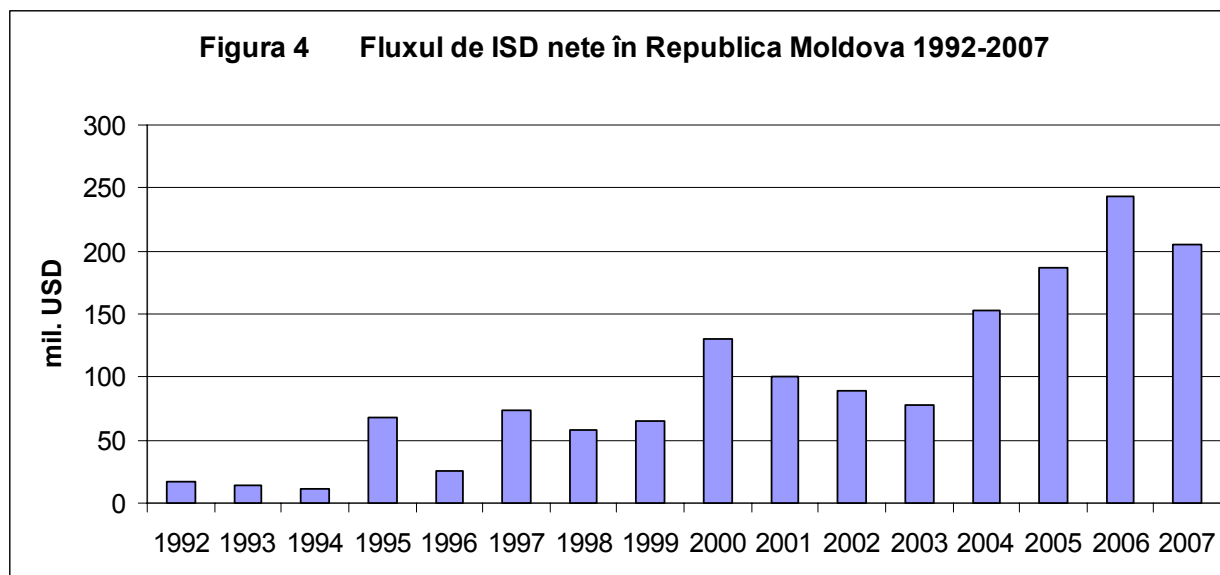
Besides all these advantages, an essential feature of the direct foreign investments is that they do not create foreign debts, which makes them very attractive for the transition economies.

At the same time, there are some risks for the transition economies when attracting foreign sources of financing, especially for the governments that did not prepare the right infrastructure for their absorption. The major risks are:

- Stronger competition that local companies face when offering lower quality products.
- Salaries offered by the foreign companies are usually higher than the average salaries in the country. As a result, there is the risk that the labor force will migrate from national companies and to the ones with foreign capital. In many situations, this is a major concern to the local Government. For example, the intention of the GEOX company, an Italian shoes manufacturer, to build a shoe factory in Moldova failed. One of the main reasons of the failure was the threat that workers from “Zorile” company will migrate to the newly built factory.
- Free capital transfers reduce the stability of the national currency.
- Establishment of high monopoly prices by the companies that function on the territory of the host country is not beneficial for the State.
- All companies, even the big innovative ones concentrate the R&D activities in their home country, and as a result of this the host countries do not fully capitalize the new developments in the field of science and innovations.

1.2. The dynamics of foreign direct investments in the Republic of Moldova.

The Republic of Moldova has entered the transition period without any stock of the foreign investments. Foreign investments started to come in 1992 when the Law on foreign investments was passed. However, until 1997 amount of investment was insignificant, because the Government was paying more attention to obtaining foreign credits than foreign investments. It was only in 1995 when the Russian company Lukoil entered the Moldavian market the foreign investments became more important. Even though after 1997 foreign investments increased, they have been very unbalanced for 10 years, without a clear trend until 2004 (Figure 4). One of the major drawbacks for the Republic of Moldova in the transition period was the absence of a clear strategy in the field of investments. There was no a detailed short-term and long-term analysis that would have established the priorities, general development directions of the country, and would outline a clear picture of the market for the foreign investors. There were not clear industrial and investment policies that would have set the priorities hierarchy in the field of investments.



Source: National Bank of Moldova

The 2007 year includes only the first semester.

Figure 4: The net FDI in the Republic of Moldova during 1992-1997

It is important to analyze the structure of the foreign direct investments in our economy. The main part of the foreign direct investments constitutes investments in shareholders' equity (table 1). At the same time, the big weight of the reinvested income from the total amount of foreign direct investments shows the long-term confidence of the businessmen that have already invested in the local economy. At the end of the first semester 2007, the reinvested incomes have equaled 8.9 % from the foreign direct investments stock, as compared to 1.9 % in 2000.

Table 1: The dynamics and structure of the foreign direct investments in the national economy.

Indicators	2000	2001	2002	2003	2004	2005	2006	2007
Foreign direct investments (net)	129,49	100,57	89,83	77,33	152,38	187,48	243,79	205,17
Shareholders' equity	84,99	106,23	58,93	41,59	106,51	65,29	115,08	102,73
Reinvested income	-2,6	-36,64	-27,43	15,34	46,42	39,33	41,59	47,45
Other capital	47,1	30,99	58,31	20,41	-0,55	82,86	87,12	54,99

Source: National Bank of Moldova

The 2007 year includes only the first semester.

According to the data provided by the Moldovan Investment and Export Promotion Organization (MIEPO), at the end of 2006, in the Republic of Moldova there were foreign investments from 86 countries, the biggest amounts coming from the European Union, followed by CIS, the United States of America, and Canada. Netherlands is the country that has invested most of all in the Moldovan economy, with a share of 21.5 % (figure 5).

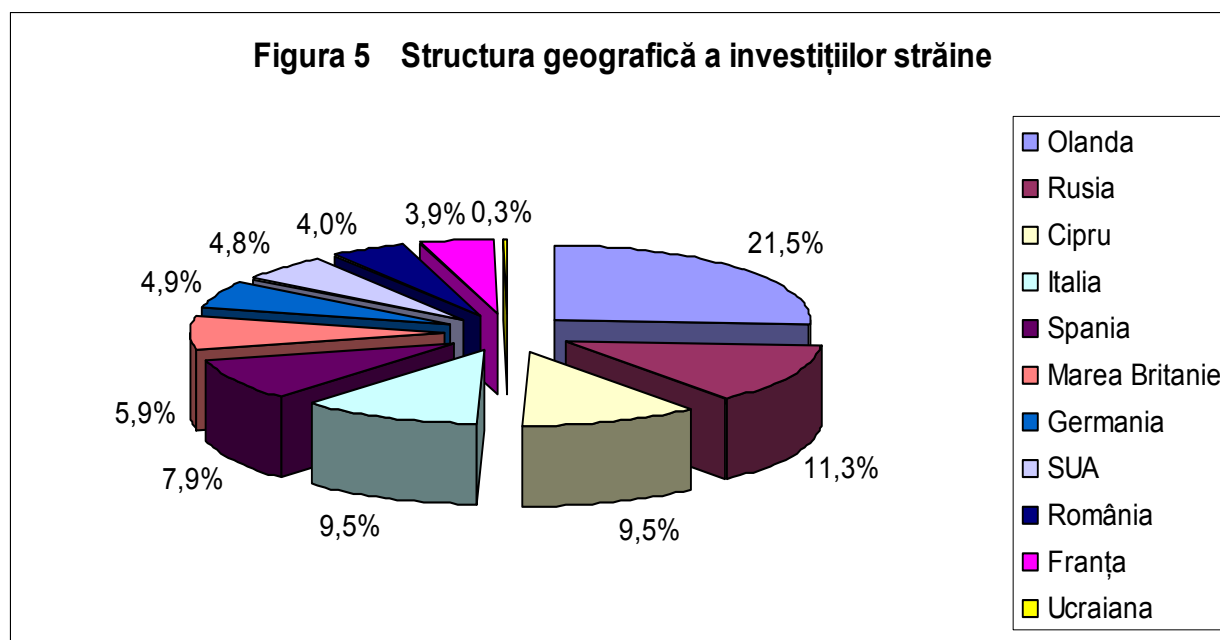


Figure 5 Allocation of the foreign investments by geographical area

Source: The Report of the Ministry of Economy and Commerce

The calculation also includes data from the first semester 2007

The biggest foreign investors in the economy of the Republic of Moldova are indicated below in table 2.

Table 2: The biggest foreign investors in the Republic of Moldova

Company	Country of origin	Field of activity
Societe Generale	France	Banking sector
Lukoil Europe Ltd.	Russia	Oil products
Union Fenosa	Spain	Energetic sector
Lafarge	France	Building materials industry
France Telecom MI	France	Telecommunications
Veneto Banca	Italy	Banking sector
METRO Group A.G.	Germany	Wholesale
Danube Logistics	Netherlands	Logistics
Mabanaft A.G.	Germany	Oil products
WNISEF	USA	Food industry, glass production, banking sector
KNAUF	Germany	Constructions

Source: MIEPO, The investment guide 2007

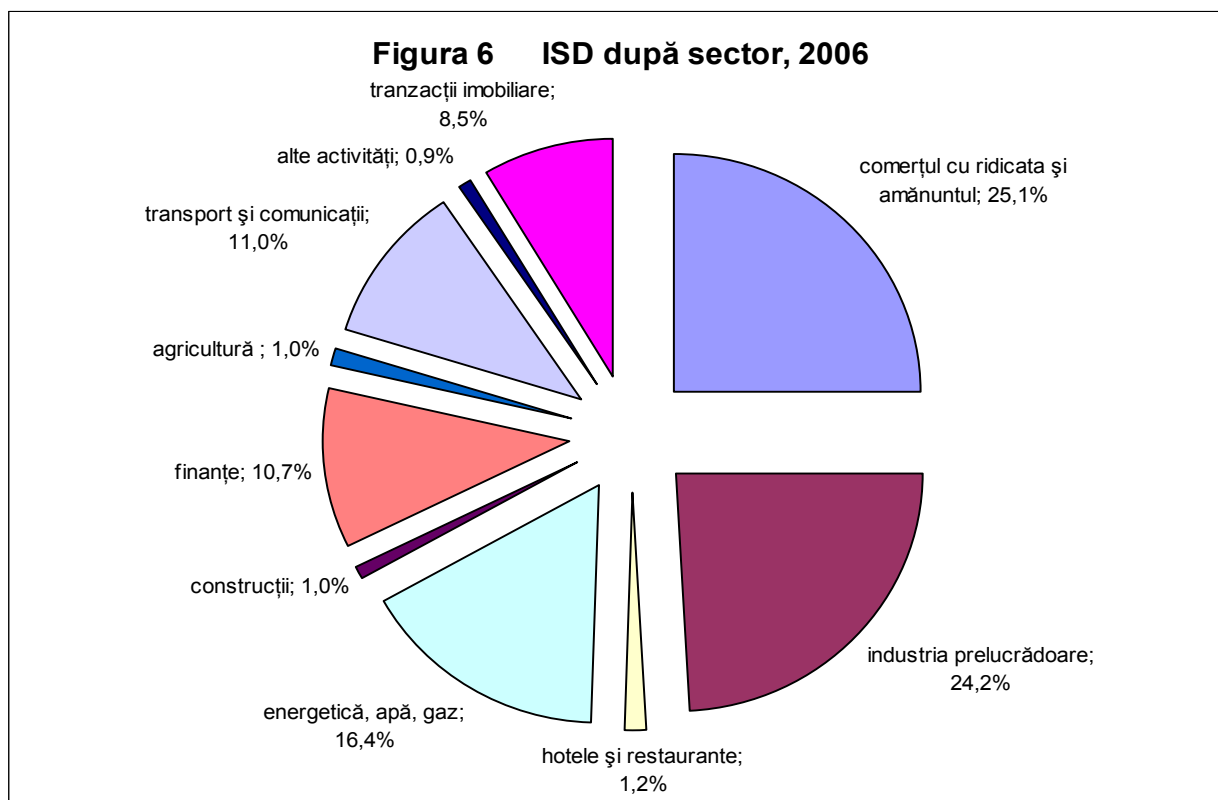
The relatively big foreign investment flows from the European Union reveals the favorable geographical position of the Republic of Moldova, which is situated near this region. The European Union has financial resources and the Republic of Moldova should benefit from this vicinity by attracting these sources. At the same time, within the European Union there also countries that still need foreign resources for financing its economy. Big capital flows from the

European Union are also oriented to much distant countries that show a high credibility ratio and offer big advantages to foreign investors. This discloses a strong competition where Republic of Moldova should create a favorable image for the foreign investors.

The foreign direct investments in the Republic of Moldova largely show the participation of the foreign investors in the privatization process, as is can be seen from the table. As a result of the privatization process on the market of the Republic of Moldova appeared such players as Union Fenosa, Lafarge, Mabanaft, KNAUF. At the same time, the privatization process, which is and essential factor of increasing the internal investments, did not efficiently contribute for sustaining and developing the investment process, providing only 1/3 of all the registered foreign investments. The privatization of some important companies such as Moldtelecom, Tutun CTC, Alfa, did not take place, and as a result our country missed the opportunities of the first privatization wave and resources for the national economy. Furthermore, by failing to privatize the above-mentioned companies, some investors have lost their interest for the Republic of Moldova as a target country for their investments, being disappointed by the local bureaucracy and lack of transparency.

According to the data from the State Registration Chamber, in the period of 01.01.1994 – 11.01.2007, 5896 companies with foreign capital were registered, which represents 4.17 % out of the total number of companies and organizations listed in the State Register. The number of “Greenfield” projects with the participation of foreign direct investments is also reduced. In 2006, their number was equal to 6 as compared to 14 in 2005, and 13 in 2004.

Speaking about the field of activity, the foreign investors prefer to invest in the sectors with a rapid revenue ratio. The biggest investments are directed in the wholesale and retail, processing industry, energetic sector, transport and communications (Figure 6). Moldova also did not manage to attract significant foreign investments in the agriculture, or in the machine building industry, the branches in which Moldova was specialized at the time of obtaining independence. This has determined a change of the structure of the national economy, with the agricultural sector diminishing its role in the formation of the GDP.



Source: National Bank of Moldova

Figure 6: FDI by sectors, 2006

Wholesale and retail, processing industry, hotels and restaurants, energy, water, gas; constructions; finance; agriculture, transport and communications, other activities, transactions with fixed assets.

Recently there have been important foreign investments made in banking sector of the Republic of Moldova. At the moment, the share of the foreign capital in the banking capital exceeds 65 %. This is the result of Gruppo Veneto Banca from Italy acquiring Eximbank, Societe Generale from France - Mobiasbanca, and Viena Capital Partners - Unibank. The investments in the banking sector offer opportunities for obtaining big and rapid profits, and the appearance of big transnational commercial banks in the transition countries is the result of globalization and strong competition that intensified after the single currency was introduced on the territory of the European Union. At the same time, the coming of strong banks can be explained by expectations that demand for the financial resources will increase. The changes in the banking system influence the crediting level, and as a result the price for credits offered to companies. At the same time, the access to borrowing financial resources is one of the economic factors that influence investors' decision for launching their activity on the territory of a specific country, and it can contribute to more foreign investments.

Despite the fact that the stock of foreign direct investments in the Republic of Moldova is not so big, there were positive effects of these investments in some sectors. For example, the German corporation "Sudzucker AG Mannheim" acquired in 1998 the majority of shares of 5 sugar

producing plants from Moldova (Alexăndreni, Drochia, Dondușeni, Făleşti, Glodeni), which led to:

- Settling the debt of the five plants;
- Replacing barter with financial payments;
- Creating additional companies that offer technical services to the farmers that plant beetroot.

This is not the only example, which demonstrates the importance of the foreign direct investment for developing the economy of Republic of Moldova. In order to diminish the negative consequences from attracting foreign capital as it was mentioned in the previous section, the state has to play a more active role in attracting these investments by establishing the priority areas for investments and eliminate the speculation games with foreign investments.

1.3. The SWOT analysis of attracting foreign investment in the Republic of Moldova

The analysis in the previous sections reveals the unfavorable investment conditions in the Republic of Moldova. This can be concluding after comparing with other states in the region, from low performance of the national economy, low level of reinvested profits which remain and the small number of Greenfield projects. But the need to attract investments in the national economy is based on the following:

- Moldova's own investment potential is very low, insufficiency of internal resources in the private sector.
- The need to integrate the Republic of Moldova into global economy on favorable terms.
- Create a competitive environment with the participation of foreign investors, raising the competitiveness of the national products.
- Having a big number of businesses which register loss, respectively having debts to the state budget. Their privatization and further sale to foreign investors will create a new business culture and the principle that a business must be profitable. Otherwise the society does not benefit from having such a company.
- The need to implement in Moldovan economy advanced technologies and economic know-how which becomes possible given the interest of foreign investors.

The raise of investments starting with year 2004 indicates that Republic of Moldova has certain advantages, which has to be explored in order to attract foreign investments. The Table 3 shows the strengths and weaknesses, as well as opportunities and threats for attracting foreign direct investments in the Republic of Moldova. At a great extent, the table generalizes the SWOT analysis made in context of the Strategy for the Mobilization of Investments and Promotion of Exports for period 2006-2015.

To benefit from the existent strengths and opportunities it is necessary to neutralize and eliminate to the greatest extent the disadvantages which obstruct the above mentioned advantages. Thus, the favorable geographical position of the Republic of Moldova won't be considered by foreign investors unless there is a developed infrastructure of roads and communications. Or the tax concessions are undermined by the high level of bureaucracy and corruption.

Table 3. The SWOT Analysis when attracting Foreign Direct Investments

Strengths: • Neighboring with EU • Favorable climate conditions for developing some types of productions and services • Bilingual business environment (Romanian and Russian) • Well developed banking system • Favorable geographical location of the country • Cheap labor • The existence of trade preferences offered by European Union • The existence of bilateral agreements on mutual promotion and protection of investments	Weaknesses: • Macroeconomic instability, high inflation rate • Poor infrastructure • Major discrepancies in regional development • Lack of material resources, including natural resources • High energy import dependence • Considerable influence of external factors on national economy • Raising deficit of skilled labor force • Insufficiently developed financial market (insurances, stock exchange market) • Insufficiently developed technological transfer • Low development of scientific and technological economic sectors • Insufficient development of consulting and information services for attracting investment and export promotion
Opportunities: • State policy oriented towards European integration • High level of consumption and its perspective for remaining unchanged on the domestic market as well on the markets of main trade partners • Selling government property using various means, including public-private partnership • Benefits for investors • De-capitalized assets which have a development potential, including infrastructure • Prerequisites for developing a new financial institutions and instruments	Threats: • Presence of administrative obstacles for attracting of investments • High regional competition for attracting investments • High labor migration mobility in the region • Reduced state capacities in financing investments in infrastructure • Lack of domestic resources for investments • Growing prices for energy resources

Source: Strategy for the Mobilization of Investments and Promotion of Exports for period 2006-2015 and analysis of the author

CHAPTER II

POLICIES AND STRATEGIES FOR ATTRACTING FOREIGN DIRECT INVESTMENTS IN REPUBLIC OF MOLDOVA

2.1. State policies for attracting foreign investments

From the beginning the activity of foreign investors in the Republic of Moldova was regulated by the law of the Republic of Moldova on Foreign Investments adopted in 1992. But having a law wasn't enough to attract investments. Foreign investors are interested in business climate, functioning of the judiciary system, guarantees offered by the host country, functioning of the market and of its institutions. But these were not the main concerns of the Moldovan Government in the past ten years, as there was no strategy for attracting investments until 2001, a situation which perfectly explains the low level of direct foreign investments during that time in the economy of the Republic of Moldova.

Nevertheless, the lack of own investment resources, as well as measures undertaken by other countries determined the Government to change its attitude and perspective on foreign investments and their role in the economy of the Republic of Moldova. It is possible that the increase in direct foreign investments after 2000 was a direct consequence of the actions taken by the Government to improve the business climate and mobilize foreign investments such as:

- Creation in 1997 of the Agency for Mobilization of Foreign Investments which since 2001 is part of the Organization for Export Promotion.
- In 2001 the Republic of Moldova joins the World Trade Organization. And since 2006 Moldova's trade relations with European Union member states are subject to trade system GSP+.
- The launch of the regulatory reform which is aimed at reducing the dependency level of businesses from administrative regulation, diminishing financial and time costs for obtaining authorizations, certificates and other permissions.
- In 2001 the first investment strategy of the Republic of Moldova for 2001-2005 was adopted. Currently the Strategy for Attracting Investments and Export Promotion is enforced. It was developed for a longer period of time 2006-2015 and was adopted by the Ministry of Economy and Commerce.
- Adoption of other strategies and national programs which provide execution of measures to contribute to economic development.
- Bilateral agreements on protecting investments were signed with 35 countries.
- In 2007 the National Agency for the Protection of Competition was created as a permanent authority within the public administration and has the purpose to promotion state policy in the following fields: protecting competition, establish control over un-loyal competition of the economic agents, public authorities, as well as supervise the law enforcement. The creation of this institution is stipulated in the EU-Moldova Action Plan.

The Law nr. 81-XV from March, 18 2004 on investments and entrepreneurial activity is the basic act which regulates the activity of foreign investors in the Republic of Moldova, while the law on foreign investments was abrogated. The Law on investments in business activity is offering to both to domestic and foreign investors the following guarantees:

- Investments shall not be expropriated or subject to any other similar measures, which can directly or indirectly deprive investor of his property right or the right to control investments (Art. 10, par. 1)
- Damages, including loss of profit incurred by investor as a result of executing any instruction of public authority which violates investor's rights, or damages caused from improper execution of duties to investor by public authorities (obligations shall be stipulated in this law and other legislative acts of the Republic of Moldova); damages shall be compensated at expense of the public authority responsible for the damage (Art. 11, par. 3)

However the Art. 11 provisions, do not take into consideration the fact that frequently local authorities are not responsible for the damage and their budgetary resources are limited. Sometimes they do not have sufficient resources for settling the damage. Thus there is little credibility that the law is functioning.

In general terms, foreign investors enjoy the same rights as the domestic ones, except from stipulation of the article 22, which provides that the foreign investors, in accordance with the legislation of the Republic of Moldova, could obtain own real estate on the territory of the Republic of Moldova, except from farm land and forest resources for business activities. Investors disagree with this provision and consider it is an obstacle for foreign investments in agricultural sector.

In order to attract investments, The Tax Code of the Republic of Moldova offers a series of tax concessions. Thus according to art. 49² investors are entitled to following tax concessions:

The residents of the free economic zones are entitled to tax concessions according with the Art. 49 of the Tax Code regarding the tax on and zero VAT for goods, services delivered to/from free economic zone from outside of the customs territory of the Republic of Moldova, delivered to the free economic zone from the rest of the customs territory of the Republic of Moldova, as well as those delivered by residents of different free economic zones of the Republic of Moldova to each other, according to the Art. 104, and excise tax concessions for goods subject to excise introduced to the free economic zone from outside the customs territory of the Republic of Moldova, from other free economic zones, from the rest of the customs territory of the Republic of Moldova, as well as goods originating from these zone and taken out of the customs territory of the Republic of Moldova according to Art. 124 of the Tax Code.

The investors in free economic zones are protected from amendments in legislation for a period up to 10 years. At the present moment in Moldova there are 6 free economic zones, five of them are located outside Chisinau.

There are also tax concessions for certain group of activities. For example:

- Investors in agriculture are entitled to: i) exemption from tax on profit on basic activity during 5 years; ii) road tax exemption; iii) concession for local taxes.
- Companies which have more than 50% of its profit based on selling software produced by them are exempted from the income tax for 5 years.

Beginning with 2008, the Tax Code contains new provisions aimed at promoting investment activity, namely:

- Reinvested profit of the legal entities will be subjected to zero tax rate. The amendments were introduced to the Tax Code by the Law nr. 111-XVI from 27.04.2007.
- The entities which run businesses and are located outside Chisinau and Balti are entitled to VAT refund for material values, procured services for capital investments, with the exception of investments made in apartments, transportation for giving incentives to investments outside these urban areas, according to Art. 101¹.

Recently the Law on state registration of legal entities and individual entrepreneurs was adopted and will be enforced during a 6 month period after publication. The law simplifies several registration and cancellation procedures from the State Register; both the number of necessary acts and the duration of the procedures have been reduced.

2.2. The need and directions for changing the investment climate in the Republic of Moldova

Despite the actions taken by the Government, investments decreased in Moldova and the per capita foreign direct investments is smaller than in other countries in the region. Thus, the actions mentioned before, although positive, have not had any significant impact on investment attractiveness of the country. Or there are other negative circumstances which create important barriers when making an investment decision compared to the actions already taken by the Government.

Therefore, it is not enough to have in place a powerful legal framework to attract investments, ***being more important to observe the law***. To attract investments, it is necessary not only to adopt the Law on investments in entrepreneurial activity, but provide equal enforcement.

Unfortunately, there were instances when the rights of the foreign investors were violated in the Republic of Moldova, one example being the case of Bimer against Moldova solved by European Court for Human Rights. The Bimer joint-stock company was registered in the Republic of Moldova and its assets were owned by investors from Moldova, USA and Bahamas. It was qualified as a foreign investment company and was benefiting from provisions of the Law on foreign investments. The company obtained two licenses for opening a duty free shop and bar at the Leuseni border for an unlimited term. In April 2002, the Parliament of the Republic of Moldova has amended the Customs Code according to which duty free economic entities should be opened in Moldova only at the international airports and on the board of the airplanes on international routes. Further, the Customs Service ordered to close all the duty free shops which were not placed in the international airport. The claimant contested the decision in the court based on the fact that the amendments introduced into the Customs Code cannot have a

retroactive effect and that application of these provisions contradicts the Law on foreign investments which suspends for 10 years the application of the laws which affect the status quo of the investors. The Supreme Court rejected the claim, considering there was not enough evidence as of September 2002. JSC Bimer made an appeal to ECHR which concluded that company's rights were violated and condemned forced Republic of Moldova to pay a 520 000 EURO compensation.

During the process of renationalization there were litigations between foreign investors and state. First of all, ***the process of renationalization itself results in lower investment attractiveness*** of the country. There were no similar cases registered in other countries from the region, which had success in attracting foreign investments. In the Republic of Moldova, some renationalization cases were characterized by violating the rights of foreign companies. A notorious example is the the experience of the American company "Europharm" in Farmaco. The conflict resulted with the expropriation of the foreign investor, while no investment expenditures or profit was paid back. This is the action foreseen in the article 19 of The Law on foreign investments at that moment. In 1998, the American company "Europharm Inc." purchased 81% of shares of the pharmaceutical plant JSC "Farmaco", owned by the state. The value of the purchased shares was 2.1 millions USD. In 2001, using the court, the Department of Privatization asked the company to sell 29% of owned shares to the state. Such request is a breach of engagements made by the foreign investor. The litigation "was solved" by the end of 2002, when the state recovered all the shares bought by "Europharm Inc", while the investor did not receive back the invested money. Unfortunately, this is not the only case, which contributed to a decrease of the number of foreign investors in Moldova.

For attracting the foreign investments, it is recommended to:

- Elaborate an applicable legislative framework and assure a trustful and transparent legal system and mechanism for enforcing this legislation. The legal environment has to be improved in the three following areas: harmonization of the legislation, legal reform and maintaining an equal business environment for all the local and foreign investors.
- Avoid the renationalization, process which negatively affects the investment attractiveness of the state.

The privatization process did not contribute to attracting foreign investments. The laws which regulate the acquisition contracts of goods and services for the state beneficiaries stipulates that any economic agent from Moldova or abroad can be contracted, if it is adequately endowed for conducting a public acquisition and has the legal right (according to the documents) to undertake this type of activity. In reality, the distribution of public acquisition contracts favored certain local competitors, which were less effective in several cases.

- If privatization shall continue, it has to remain transparent, while the number of objects submitted for privatization should grow. For example, Estonia, the country with the biggest amount of foreign investments per citizen from the ex-Soviet Union, has attracted large foreign investments during the privatization, leaving only the main harbor, electric networks the national mailing system and the national lottery in the state's property.

- An ideal situation for investors would be a fair and transparent distribution of the acquisition contracts to all the investors, including the foreign ones.

The **fiscal concessions** are attractive especially for the foreign investors who have the possibility to increase the statutory capital by 2 million USD. But the number of companies which can pretend to this concession is not so big, while the 250 thousand USD amount is big for small companies. Thus, the number of companies which will benefit from these concessions will not be large. A part of companies will not obtain them because of the lack of capital, while others, do not meet requirements. According to the data provided by the State Fiscal Service, in 2006 12 companies with foreign investments received fiscal concessions.

Fiscal concessions alone can not create artificially a favorable economic environment or compensate the weak industry base or solve the problems related with the political stability. This mechanism is more important in the second stage of the investment decision, when from the list of possible investment placements established in the first stage, incentives can provide an advantage compared with other options. The role of incentives becomes more important when the market operates close to the international standards, where the decisions related to investment issues are relatively stable.

Not even imposing the 0% rate on reinvested profit which should stimulate investments may help achieving the goal. The most important aspect in reducing the fiscal obligations is not the reduction of the income tax for legal entities, which is not so high in the Republic of Moldova, but reducing other taxes and contributions (social contributions, profit tax for individuals, VAT, local taxes) which in Moldova remain high. Another factor perceived as being negative by the foreign investors is the fiscal amnesty from 2007. This is a measure which majority of state companies benefited from rather than foreign investors.

- It is necessary to exclude the fiscal incentives as fiscal amnesty, which could conduct to lack of fiscal indiscipline of the constant tax payers and can affect country's image for potential foreign investors.
- The concessions offered to the investors can be diversified. For example, in Czech Republic, besides the 10 year income tax concession for investments greater than 10 million USD, there are grants provided for creating work places, grants for retraining the employees as well as there as a possibility or purchasing land at a lower price.

Transparency and bureaucracy. The probability of bribes and corruption, as methods to bypassing the system, will be higher if there will be more formalities, excessive regulations and government interventions. Even if there was certain progress in fighting with bureaucracy by means of Guillotine 1 and Guillotine 2, public authorities intervention is still consistent, having in several cases political background.

The Republic of Moldova registers a small progress in improving the business environment, positioning behind other countries international ratings. According to "Progresses registered in Reforms and Policies for improving the investment environment in South-Eastern Europe 2006" research, Moldova placed below regional average concerning most reform sectors. The country placed above South Eastern European average on starting a business and anti-corruption. The

“Doing Business 2008” research, performed by the World Bank lowered Moldova two positions below the previous year level, and placed 92nd out of 178 states. Corruption represents a serious impediment for many investors. According to the rating compiled by The American Heritage Foundation and The Wall Street Journal reflecting economic freedom, in Moldova corruption freedom is only 29%². The same research emphasized investment freedom, which is 30%, much below the world average.

Thus, for creating a favorable investments environment, the following actions should be taken:

- Continuous promotion of the regulation reform and avoiding the extension of its implementation terms.
- Eliminating corruption should be the major priority of local authorities in order to attract foreign and local investments. This fact implies providing competitive salaries to the public workers, intensify their control, educate the political and public responsibility and create a transparent working environment using efficiently the informational technologies.
- Position in international ratings represents a reference index for potential investors; thus, having the purpose to gain some positions may generate internal incentives for solving transparency and bureaucracy problems.

Shadow Economy of Moldova. Many local companies are working in the shadow economy: they do not declare their incomes and do not pay the respective taxes. It is less likely that foreign investors will invest in these companies or in sectors where the majority of companies have same practice.

- It is necessary to change the trend of the underground economy. A stable management of the fiscal system and the attenuation of bureaucratic constraints will stop the migration of the economic agents towards the underground sector.

Despite establishing the **Moldovan Investments and Export Promotion Organization (MIEPO)** there is little result seen for attracting foreign investments in the country. It is certain that in other countries, with a more favorable business environment and a higher level of development, the investment promotion is more efficient. Still, a more consistent effort from the national investment promotion agencies is required. If these agencies do not take proper actions for attracting investments, they will face the utility issue in the framework of long term government's policy. The efficient agencies are systematically contacted by potential investors, which is not the case of MIEPO.

In this case it is necessary:

- To supervise the efficiency of this organization. It is necessary to have qualified and motivated staff, outline certain requirements for this organization; establish some performance indicator in their activity.
- MIEPO should contribute to attracting investors with a direct implication through certain proposals and projects, providing pre- and post- investment services to the potential

² 100%represents the maximum liberty, the optimal situation.

investors and to the current investors (informational support and assistance, provide solutions to the problems which foreign investors face in Republic of Moldova).

Another institution created recently is ***The National Agency for Competition Protection (ANPC)***, which is mentioned in the EU – Republic of Moldova Action Plan. The start of this agency was supported by the Association Foreign Investors (FIA). From the beginning of its activity, foreign investors raised several complaints against its fines, which FIA interpreted as abusive. The amount of penalty is the direct consequence of not having a clear mechanism for calculating such fines. Even though FIA initiated this agency, it has foreseen the abusive risk because of gaps in legislation. The proposals for changes were included in the White Book 2006, published by FIA.

- Improve the legislation on competition protection; establish methodology and instruments for detecting and monitoring the anti-competition actions and measures for penalty.
- Concerning MIEPO, it is important to provide the efficiency and qualified personnel in this sector.

Underdeveloped infrastructure is one of the major problems of the Moldovan economy, which represents an obstacle for the economic growth, improvement of the living standards and attraction of the foreign investments outside Chisinau and Balti. Unfortunately, the solution to these problems is significant public investments, while the financial resources are scarce. Still, public investments in infrastructure will constitute a country advantage when attracting foreign investors. Among other advantages one may consider the favorable geographic position and the neighboring with the European Union.

It is necessary to:

- Establish some permanent sources for financing the investments in infrastructure. The strategy for attracting foreign investments and promotion of exports stipulates the financing of investments in infrastructure from dividends paid by companies which have the state a major stock holder and from sources resulted from the privatization of the public property. However the proportion and exact amount are not clear yet.
- Provide fiscal concessions to companies which invest outside Chisinau and Balti or in places farther than 50 km from the cities, in order to provide a regional development.

Not even adopted strategies brought expected results for attracting foreign investments. During the implementation of the first strategy, even if it was designed correctly, many actions were not accomplished in time. Unfortunately, these are not only investment strategies, but also other country strategies, which lag behind implementation terms. The current strategy for Promoting Exports and Attracting Investments stipulates the implementation terms and responsible body. Many of these actions were already performed. Their main disadvantage is not observing the ***mechanism for monitoring the progress in attracting foreign direct investments***.

- The monitoring and evaluation mechanism should have a major role in implementing the strategy. This would reduce the tendency to implement the majority of actions by the end of the period.

Also the strategy does not identify the priority sectors where to attract investments, rather creating favorable conditions for developing all the sectors. It is a good option but least possible. Unlike this project, the „Foreign Direct Investment and Export Development Vision and Strategy 2006-2010” project prepared by OECD Investment Compact for the Government of the Republic of Moldova, identifies **5 priority sectors** of the Republic of Moldova which require investments:

- Informational and Communication Technologies
- Agriculture
- Textile
- Business/technical distant services for other countries
- Sustainable energy.

There are real actions described for attracting the investments in each sector in part. This method was successfully applied in Hungary, which in „Smart Hungary Incentive Program” specifies the priority sectors for investments and the less developed regions where these should be attracted as well as establishing the steps for achieving each goal.

It is necessary to stimulate investments in agriculture, which used to be the main branch of the economy, while in present it has a smaller contribution to the economic development. One of the major problems of this branch is the dependence on the weather conditions, which could be solved through the installation of irrigation systems in places where it is possible and change the structure cultivated plants, where the irrigation is impossible or requires high costs. The small farmers do not have sufficient resources to install them. The public investments are also scarce and do not have to be spent on installing the irrigation systems, having other more important destinations. Attracting the foreign investments implies:

- Eliminating the obstacles for purchasing agriculture fields by foreign investors. Foreign investors complain that this interdiction is against the stipulations of Annex 1B from GATT, article XVI, article 1 from the Directive of the Commission 88/361/CEE, and p.2.4.2 paragraph (1) from the RM-UE Action Plan which implies „the abolition of all the discriminatory measures against the foreign investors”.

Cheap labor force does not mean it has the necessary qualification. In the Republic of Moldova, **the problem of qualified labor force** becomes more stringent as a result of the intense migration abroad.

- Adopt strategies for improving labor skills requires better university studies adjusted to the investment priorities.
- Concentrate on quality of studies and not volume.
- Adjust the labor standard to the European ones.

The success in attracting foreign investments depends on how local authorities will collaborate with the foreign investors. In the Republic of Moldova there is no clear collaboration between the Ministry of Economy and Commerce, The Association of Foreign Investors, MIEPO and other responsible bodies. Thus, the White Book with recommendations for the Republic of Moldova's Government aimed at creating a favorable business environment did not have the expected impact. For example, within the Hungarian Government, there is a Council which combines investors, economists, representatives of the Chamber of Commerce. They work together to formulate policies, strategies and forward their proposals to the government.

- Create a Commission which will combine foreign investors, representatives of the Ministry of Economics, MIEPO, and ANCP to periodically analyze the situation of foreign investments, and formulate proposals for policies to improving the investment environment.

Occasional evaluation of the policies for attracting foreign investments represents the solution to a long term success for attracting foreign direct investments and optimizing their benefits.

CONCLUSIONS AND RECOMMENDATIONS

At the current moment, the Republic of Moldova is among the most disadvantaged countries in terms of foreign direct investments, being placed among the last 5 states from the South-Eastern Europe and CIS by FDI per capita. The main reasons for failing to attract foreign direct investments are:

- Lack of a strategy for attracting the investments in the beginning of the transition period.
- Lack of own natural resources.
- Missing the first wave of privatization and the lack of transparency during the privatization process. The renationalization cases and other violations of the investors' rights had a negative impact on country's image.
- High level of corruption and bureaucracy.
- High competition among the region's states for attracting foreign capital.

As a result, the Republic of Moldova received less than 400 USD foreign investments per citizen. These investments are mainly done in retail and en gross trade, processing industry, energy, gas and only 1% was allocated to agriculture, which used to be the main economic branch when acquiring the independence.

Starting with 2004 foreign investments registered a positive growing trend in the economy of the Republic of Moldova. Meanwhile, it should not be neglected that investment grow in other countries is faster, and there is a stronger competition between the states from the region and other parts of the world. Most Government actions are positive; however, many times they are being left on the paper or given little attention because of bureaucracy, lack of transparency and corruption.

Neighboring with the European Union, the main source of foreign direct investments in Moldova, offers advantages which should be used correctly. Upon conducting the analysis of the current government policies for attracting foreign direct investments and the obstacles foreign investors face, the following should be taken as **recommendations**:

- Continue to promote the regulation reform and avoid extending implementation terms.
- Create a clear concept referring to the role of foreign investments for the Republic of Moldova (increasing employment, regional development or technological development of the state) and elaborate of strategies and policies for attracting the investments depending on this aspect.
- Define and approve the economic fields which require investments. Meanwhile, investments in other sectors should not be rejected.
- Create a positive image of the Republic of Moldova at the country level by distributing promotional materials or undertake actions designed for attracting foreign investors according to the international practice (updating the Internet database, publishing and distributing promotional literature). Assure that Moldova's performances in improving the investment environment are observed by investors from the entire world.
- Elaborate a viable legal database and assure a trustful and transparent legal system and mechanism for enforcing this legislation.

- Eliminate of discriminatory measures from the legislation of the Republic of Moldova which affect the foreign investors.
- Improve the legal framework used by ANCP. Establish methodology and instruments used for detecting and monitoring the anti-competition actions and the control limits.
- Assure the MIEPO efficiency through qualified personnel, goal oriented work towards attracting investments.
- Invest in infrastructure. Foreign investors will ignore the regional advantages outside Chisinau and Balti, if the infrastructure of these regions remains underdeveloped. Choose a permanent source for investments in infrastructure. Provide fiscal incentives for investments made outside these two municipalities.
- Provide other incentives besides the fiscal ones.
- Create a Commission comprising foreign investors, representatives of the Ministry of Economy and Commerce, MIEPO, ANCP to periodically analyze the situation in the foreign investments area, and formulate proposals and variants for certain policies for improving the investment environment.
- Evaluate occasionally the policies for attracting FDI, which constitutes solution for a long term success in attracting foreign investments and for optimizing its benefits.

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