ISSUE NO. 64 | MARCH – APRIL 2021

German Economic Team

NEWSLETTER

MOLDOVA

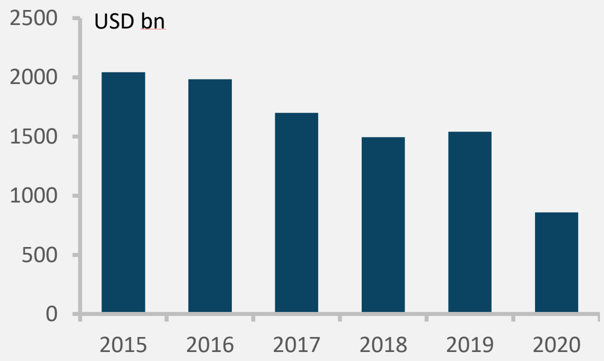
Adjusting to FDI trends in the context of the pandemic

Investment is central to growth and sustainable development. However, current conditions are challenging, with global FDI declining in recent years and the severe impact of the COVID-19 pandemic on investment flows and global value chains (GVCs). At the same time, changes in investment patterns and the transformation of value chains that have been accelerated by the pandemic also open up opportunities for the development of Moldova's economy. Those include attracting nearshoring projects and benefiting from a diversification and regionalisation of value and supply chains. In such a situation, it is of critical importance that investment attraction measures are as effective as possible. Tapping this potential requires a coherent and targeted approach, focusing on value chains that offer the most promising potential in light of the transformation process and utilising synergies between investment attraction and cluster development measures.

Severe impact of the pandemic on global FDI flows

Global FDI flows and value chains are under severe pressure as a result of the pandemic. According to UNCTAD, FDI decreased by 42% in 2020 at the global level and by 28% in South-East Europe. Global inflows are projected to fall by a further 5 to 10% in 2021. Growth in FDI is not forecast to return before 2022.

Global FDI inflows



Source: UNCTAD

At the same time, the COVID-19 pandemic is also accelerating a range of pre-existing megatrends, which strongly affect investment patterns and the configuration of value chains. Already before the pandemic, international value chains had entered a period of transformation and global FDI flows were declining. Following two decades of rapid expansion, GVC-related investment in physical assets stopped growing after 2010. Tech-driven investments, which do not need a large physical presence, became more important.

The transformation of international value chains is expected to continue, driven by technological changes – e.g., the digital transition and advanced manufacturing – as well as global economic governance and sustainability trends. In addition, companies are now reviewing where products are sourced, where each activity is located and how value chains are organized to increase resilience to future shocks.

Transformation process also opens up opportunities

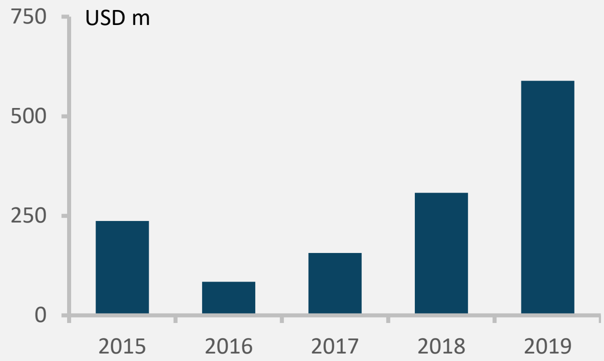
Despite several challenges such as relocations, a shrinking pool of efficiency-seeking investment and tougher competition, the transformation process also opens up new opportunities for Moldova to attract investment. Drawing on the latest World Investment Report, the following scenarios can be identified, which offer promising investment and development potentials for Moldova:

- Nearshoring: EU investors are expected to relocate and concentrate more activities in hubs close to their home countries in particular in higher-technology value chains. This scenario creates opportunities to attract investment from new target groups and to develop new value chains and industries (e.g., electronics, machinery and equipment).
- Diversification of value chains: This scenario will lead to a wider geographic distribution of economic activities and value chains to mitigate risk exposure. Amongst others, in low-tech manufacturing industries such as textile and apparel, but also in higher value service industries, large companies are likely to diversify and increasingly adopt digital solutions. This scenario offers promising potentials to further diversify the target group spectrum and economic structure and to develop Moldova as a business process outsourcing (BPO) and IT hub.
- Building up regional value chains: Investors that have more limited scope for re-/nearshoring or diversification, e.g., in extractive and regional processing industries, could also replicate value chains in regions of strategic relevance. For Moldova, this scenario brings opportunities to upgrade regional value chains such as in agro-processing and construction materials and to foster linkages between investors and local SMEs.

In principle, Moldova is well positioned to benefit

Building upon its track record in attracting investment as well as its existing strengths such as the location at the doorstep to the EU, the cost-competitive labour force and industrial tradition, Moldova is in a favourable position. Bucking the global trend, Moldova could significantly increase FDI inflows in the second half of the past decade, although from a low base. In particular, export-oriented projects, for example in the automotive supply industry, could be attracted, fostering the integration into global value chains.

FDI inflows in Moldova



Source: UNCTAD

Moldova also made progress in terms of upgrading in international value chains, promoting linkages and integrating foreign investors in cluster development initiatives.

Despite this progress, cluster development is still at an early stage and there is a rather strong focus on vertical specialisation and efficiency-seeking investments, concentrating on specific segments in low- and medium-tech value chains. Knowledge- and technology-oriented industries still account for a low share of overall and manufacturing FDI in Moldova.

A coherent and targeted approach is needed

In light of changing investment patterns and a declining pool of efficiency-seeking investment, competition between locations will intensify and investors will become more demanding preferring hubs with established cluster structures. Tapping the potential requires a targeted and coherent approach.

Targeted investment attraction efforts need to be intensified focusing on value chains that offer the most promising investment and development potential.

All transformation scenarios entail a need for the development of clusters and industrial ecosystems to extract more value from investment and increase the attractiveness from the perspective of new investors. Particular emphasis should be placed on strengthening the skills base, the digital capacity and infrastructure as well as on promoting linkages between investors, local suppliers, educational and research institutions. A systematic aftercare approach has proven helpful to scale up investments, to foster linkages and to integrate international investors in cluster development initiatives.

Such a coherent approach using synergies between investment attraction and cluster development is complex and requires the alignment of various policy tools and areas. With respect to investment policy, this relates, amongst others, to developing a needs-oriented portfolio of investment sites – including innovation and technology parks – and refining the incentive framework focusing more strongly on linkages and skills development. To maximise the impact, it is important to align further policy areas such as entrepreneurship, innovation, education and training accordingly and to ensure effective inter-institutional coordination.

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A more comprehensive analysis is provided by the Policy Briefing: Impact of the COVID-19 pandemic on global FDI and value chains.

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