

FDI attraction as a key priority of economic policy making in the Republic of Moldova

Björn Vogler, Dr Ricardo Giucci, Carolin Busch

Berlin/Chişinău, June 2021 [Update September 2021]

Executive summary

Considering the positive direct and indirect effects, FDI attraction should form a key priority of economic policy making to support the recovery and increase resilience to future shocks

- Companies with FDI make an important contribution to Moldova's economy and the state budget:
 - They account for about a quarter of value added and a third of CIT revenues
 - Their productivity and wages are significantly higher than those of domestic firms
- FDI also contributes to innovation and integration in international markets
- In light of limited resources and the impact of the pandemic on FDI flows, it is critical to concentrate efforts on the target groups with the highest potential
- From today's perspective, the focus should be on machinery and equipment, automotive, electronics and IT / BPO
- The key to success lies in an alignment of all relevant policy tools guided by comprehensive road maps to attract investment from those target groups
- Finally, there is a need to strengthen the institutional structure and capacities for targeted investment attraction measures

Outline

1. Introduction
2. Why FDI as a key priority for economic policy making?
3. Designing the policy package
 - Focus efforts on the target groups with the highest potential
 - Align relevant policy tools guided by comprehensive road maps
 - Ensure adequate institutional structures and capacities

Annex: Exemplary rapid assessment of potential target groups – machinery and equipment

1. Introduction

This policy briefing assesses the potential of FDI attraction as a priority of economic policy making in Moldova and provides recommendations for the design of the corresponding policy and institutional framework

- Current economic conditions are challenging in light of the disruptions caused by the pandemic
- There is a need to set priorities in economy policy making to support the recovery and increase resilience to future shocks
- Considering international experience, FDI attraction could form one of those strategic priorities
- Against this background, this policy briefing reviews the direct and indirect effects of FDI on Moldova's economy as well as at the international level
- Based on this review, recommendations for the design of policy measures are derived with particular emphasis on:
 - Targeted approach concentrating on industries with the highest potential
 - Road maps to attract investment from those industries aligning relevant measures
 - Effective institutional structures for the implementation

2. Why FDI as a key priority for economic policy making?

A policy study by the German Economic Team (PS/01/2017) confirms an important contribution of FDI to Moldova's economy based on an analysis of data from the National Bureau of Statistics:

- Companies with FDI (i.e. wholly owned or mixed ownership) form an essential part of the economy accounting for:
 - 7% of total companies
 - 15% of total employment
 - 23% of total value added
- They are on average about 70% more productive than domestic companies, which yields a higher level of economic growth
- Wages of companies with FDI are more than 50% higher than average wages, improving the wellbeing of the population and mitigating emigration

Contribution of companies with FDI in Moldova

Indicator	Share of companies with FDI
Number of enterprises	7%
Value added	23%
Employment	15%
CIT revenues	34%
Social security contributions	21%

Sources: German Economic Team, National Bureau of Statistics 2017

2. Why FDI as a key priority for economic policy making?

A policy study by the German Economic Team (PS/01/2017) confirms an important contribution of FDI to Moldova's economy (cont.):

- Companies with FDI also play an important role for the state budget:
 - Accounting for 34% of CIT revenues
 - Contributing to other taxes through higher wages
 - Stabilising the social system through higher social security contributions
- Finally, companies with FDI have a higher export-orientation than domestic companies
 - About two thirds of the production of companies with FDI is exported – compared with approximately one third in the total manufacturing sector
 - The exports provide external stability by helping to contain Moldova's current account deficit

2. Why FDI as a key priority for economic policy making?

As confirmed by recent OECD reports, FDI can provide additional benefits to host economies – in particular with respect to innovation and access to markets

- According to the report “Investment Perspectives in Eastern Partner Countries” (2020), foreign investors contribute to innovation capacity
 - Innovation is highlighted as one area, in which FDI appears to make a clear contribution in Eastern Partnership (EaP) countries
 - Foreign companies in EaP countries perform significantly better than domestic firms in the dimensions product innovation, process innovation and greater use of foreign technologies
- The reports “FDI Qualities Indicators” (2019) and “Mapping of Investment Promotion Agencies in OECD Countries” (2018) emphasize the local diffusion of expertise especially through local linkages
 - Foreign investors often bring new technologies in recipient economies and FDI can thus lead to local technology transfers and innovation spillovers
 - FDI also creates jobs indirectly through backward and forward linkages with local SMEs and can enhance human capital through the dissemination of new skills, know-how and management techniques

2. Why FDI as a key priority for economic policy making?

As confirmed by recent OECD reports, FDI can provide additional benefits (cont.)

- Furthermore, those reports stress the contribution of FDI to integration in international markets and value chains
 - FDI can support host economies' global trade integration by providing them with improved access to international markets and developing local export capabilities
 - By linking domestic firms to foreign investors, FDI serves as a conduit for domestic firms to integrate in global value chains
- In the case of Moldova, FDI can play an important role in strengthening the economic integration with the EU
 - In the recent past, several EU investors were already attracted, fostering the integration into European value chains
 - By securing further export-oriented investment projects, Moldova could make better use of the Deep and Comprehensive Free Trade Area (DCFTA)
- **From our point of view, the presented findings on the direct and indirect effects call for FDI attraction as a key priority of economic policy making. Subsequently, recommendations for the design of the policy package are derived**

3. Designing the policy package

In light of limited resources and the impact of the pandemic on FDI flows, it is critical to focus efforts on the target groups with the highest potential

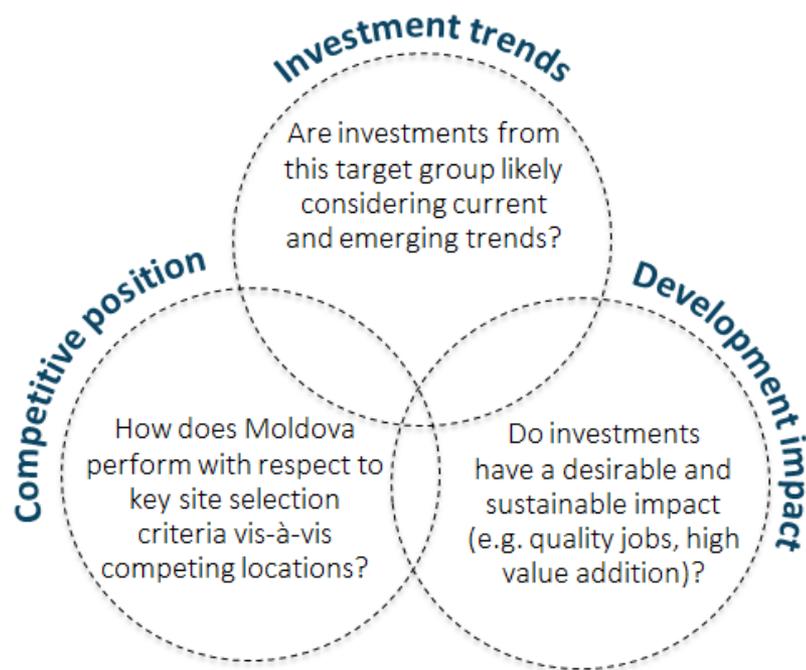
- Current conditions are challenging, with global FDI declining in recent years and the severe impact of the pandemic on international investment flows
- The pool of efficiency-seeking investment, which played an important role for Moldova in the recent past, is shrinking
- At the same time, changes in investment patterns and the transformation of global value chains that have been accelerated by the pandemic also bring new opportunities for the development of Moldova's economy
- The nearshoring trend and the diversification of value chains offer promising potentials to attract investment from new target groups and segments and to develop new and upgrade existing value chains
- In such a situation, it is of critical importance for investment attraction efforts to be as effective as possible

3. Designing the policy package

In light of limited resources and the impact of the pandemic on FDI flows, it is critical to focus efforts on the target groups with the highest potential (cont.)

- Tapping the potential requires a targeted approach, focusing on industries with the highest potential considering the dimensions:
 - Investment trends
 - Competitive position
 - Development impact
- The following target groups should be prioritized from today's perspective:
 - Machinery & equipment (see exemplary rapid assessment in the annex)
 - Automotive
 - Electronics
 - IT/BPO

Key dimensions for selecting target groups for investment attraction measures



3. Designing the policy package

The key to success lies in an alignment of all relevant policy tools guided by comprehensive road maps for the identified target groups

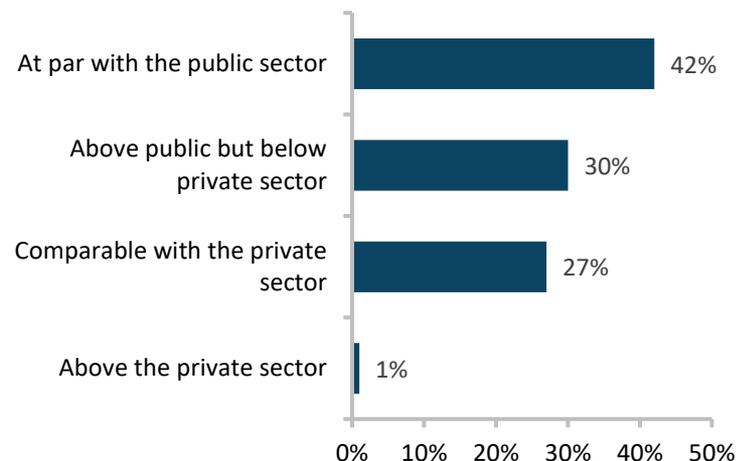
- Efforts need to be intensified beyond investment promotion to shift the focus from efficiency-seeking investments towards higher value activities
- Competition is intensifying and investors, particularly those from more knowledge and technology-oriented target groups, are becoming more demanding with respect to their location requirements
- A competitive value proposition depends upon the effective interaction of several policy tools and areas
- Based on an assessment of investors' needs in the identified target groups, comprehensive road maps should be developed that cover the entire investment attraction cycle and integrate measures in areas such as:
 - Training and education (e.g. needs-oriented study and vocational training courses)
 - Linkage promotion (e.g. innovation transfer/supplier development programmes)
 - Investment sites and infrastructure (e.g. specialised and innovation-driven zones)
 - Incentives (e.g. shifting the focus towards quality jobs and training)

3. Designing the policy package

Effective investment attraction requires adequate institutional structures and capacities

- A targeted investment attraction approach relies on specific expertise and skills
- Investment promotion agencies (IPAs) must be able to recruit and retain highly qualified employees
- Their staff works at the interface between the top level of the public and private sector in an international environment
- Fluctuation is a major impediment for building up the necessary capacities and contact networks
- Against this background, the majority of IPAs at the international level offer above-public sector salaries

IPA's staff salaries at the international level



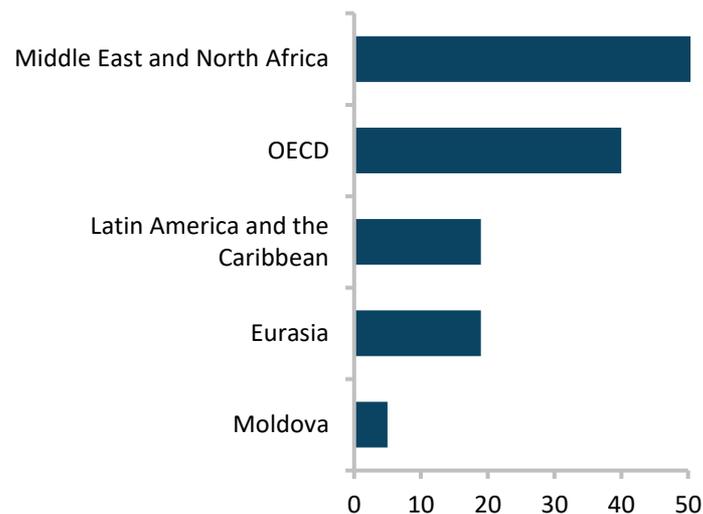
Sources: World Association of Investment Promotion Agencies (WAIPA), World Bank Group, 2020

3. Designing the policy package

Effective investment attraction requires adequate institutional structures and capacities (cont.)

- With the existing resources, the Moldovan Investment Agency (MIA) cannot fully unlock the potential of a targeted approach
- MIA is understaffed in international comparison with five positions for investment promotion, which currently are only partly filled
- MIA's salaries are significantly lower than in agencies of competing locations such as North Macedonia and Albania
- Due to the constrained resources, MIA cannot develop the necessary specialisation, structures, processes and investor relations

Number of investment promotion staff in IPAs in different regions



Source: OECD 2020, own research

3. Designing the policy package

Effective investment attraction requires adequate institutional structures and capacities (cont.)

- Thus, there is a need to strengthen resources and capacities for targeted investment attraction measures
 - Introducing a target-group-oriented organisational model with industry specialists
 - Covering the entire investment attraction cycle incl. widening the scope of facilitation and aftercare services
- Political commitment constitutes a key success factor
- Active involvement and coordination at the top level of government needs to be ensured, e.g. by a dedicated state secretary



Source: Own research

About the German Economic Team



Financed by the Federal Ministry for Economic Affairs and Energy, the German Economic Team (GET) advises the governments of Moldova, Georgia, Ukraine, Belarus and Uzbekistan on economic policy matters. Furthermore, GET covers specific topics in other countries, such as Armenia. Berlin Economics has been commissioned with the implementation of the consultancy.

CONTACT

Carolin Busch, Project Manager Moldova
busch@berlin-economics.com

German Economic Team
c/o BE Berlin Economics GmbH
Schillerstraße 59
10627 Berlin

Tel: +49 30 / 20 61 34 64 0
info@german-economic-team.com
www.german-economic-team.com

Implemented by



Annex: Rapid assessment of target groups – machinery

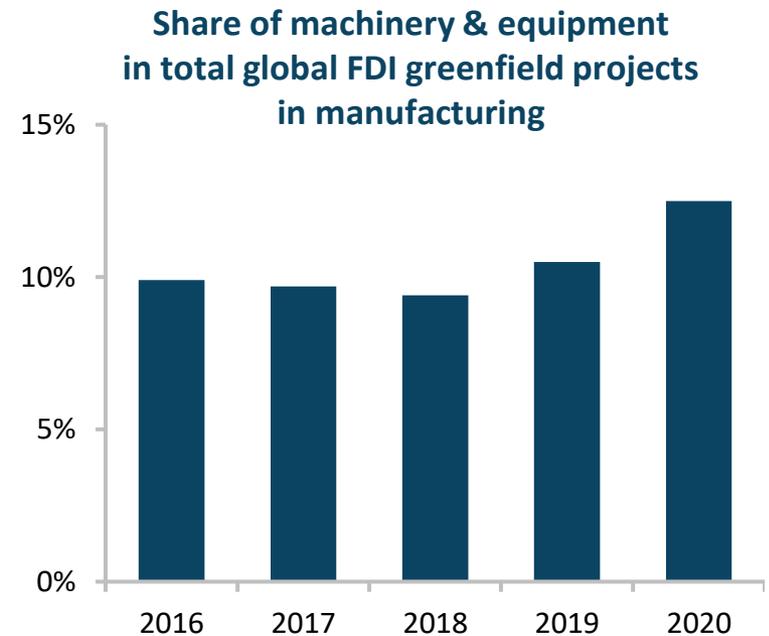
Building upon a long standing tradition, the machinery & equipment industry in Moldova covers a broad range of product groups and application markets

- Key segments include, amongst others:
 - Agricultural equipment (e.g. Moldagrotehnica, Mecagro)
 - Food processing machinery (e.g. Berhord)
 - Pumps and motors (e.g. CRIS, Moldovahidromas, Hidroinpex)
 - Lifts & elevators (e.g. BASLIFT)
 - Hydro-acoustic and navigation equipment (e.g. RAUT, RIF-ACVAAPARAT)
- In addition, several companies provide relevant components and services (e.g. plastics and metal products, engineering and maintenance services)
- According to a recent study by the International Trade Centre, the machinery & equipment industry in Moldova has approximately 12,000 employees
- The next pages summarise the results from a rapid assessment of the investment attraction potential focusing on the dimensions (i.) investment trends, (ii.) competitive position, (iii.) development impact

i. Investment trends

Machinery & equipment is among the leading manufacturing industries in terms of global FDI greenfield projects – with a proven track record in transition economies

- In the recent past, machinery & equipment displayed strong investment dynamics at the international level
- During the last five years, the industry accounted for about 10% of all FDI greenfield projects in manufacturing
- In 2020, machinery & equipment was one of the top three manufacturing industries in terms of FDI projects – ahead of automotive and chemicals
- Although the number of projects declined, the share in total FDI projects increased as other manufacturing industries were more seriously affected by the pandemic



Source: UNCTAD 2021

i. Investment trends

Recent enquiries and projects confirm a promising potential and the future outlook remains positive considering the nearshoring trend

- Among other machinery and equipment companies, the German Magnetec Group has recently invested in Balti creating approximately 70 new jobs
- The company is supplying materials and components for the machinery, electrical engineering and further industries
- In light of changes in global value chains and FDI patterns in the context of the pandemic, the industry offers a promising potential
- According to recent UNCTAD reports, machinery & equipment belongs to the industries, which are expected to show substantial nearshoring activities

Top 5 manufacturing industries by number of FDI greenfield projects in 2020

Industry	Number	Share
Electronics and electrical equipment	862	16.8%
Textiles, clothing and leather	647	12.6%
Machinery and equipment	640	12.5%
Automotive	558	10.9%
Chemicals	442	8.6%

Sources: UNCTAD 2021

ii. Competitive position

In principle, Moldova is well positioned to attract investment from the machinery & equipment industry building upon its existing strengths, e.g. location at the doorstep of the EU and attractive cost structures

Moldova offers favourable conditions for investment projects in the machinery & equipment industry, including:

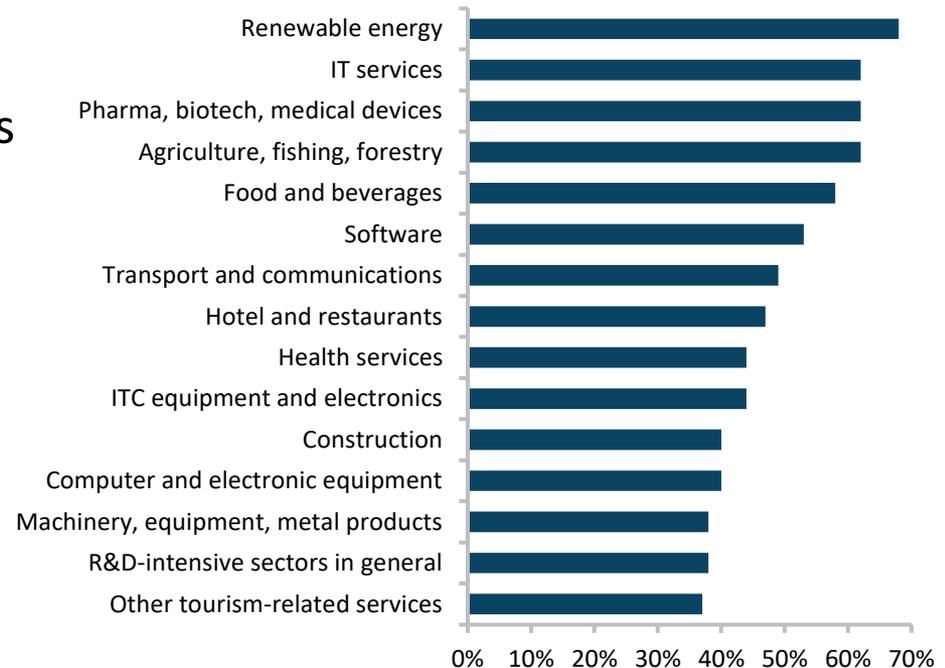
- Proximity and preferential access to key markets based on several FTAs
- Competitive operational costs (in particular labour costs)
- Educational system with a strong focus on the needs of the industry, e.g.:
 - Technical University of Moldova with competences in mechanical, power and electrical engineering and electronics
 - Balti Polytechnic College
 - Dual VET programmes in mechatronics and electronics
- Free Economic Zones and Industrial Parks with a range of relevant incentives, facilities and services (e.g. training facilities and services in FEZ Balti)
- Wide spectrum of cooperation opportunities within the business landscape
- Industrial tradition

ii. Competitive position

However, competition between locations is increasing. Efforts need to be intensified in particular in the areas skills development and linkage promotion

- As confirmed by recent surveys, an increasing number of IPAs is targeting the machinery & equipment industry
- At the same time, investors become more demanding preferring locations with established cluster structures
- Thus, efforts need to be intensified in particular in the following areas:
 - Improving the quality of relevant educational programmes
 - Developing the supplier base
 - Promoting linkages between the industry, educational and R&D institutions

Top 15 target groups as designated by IPAs around the globe



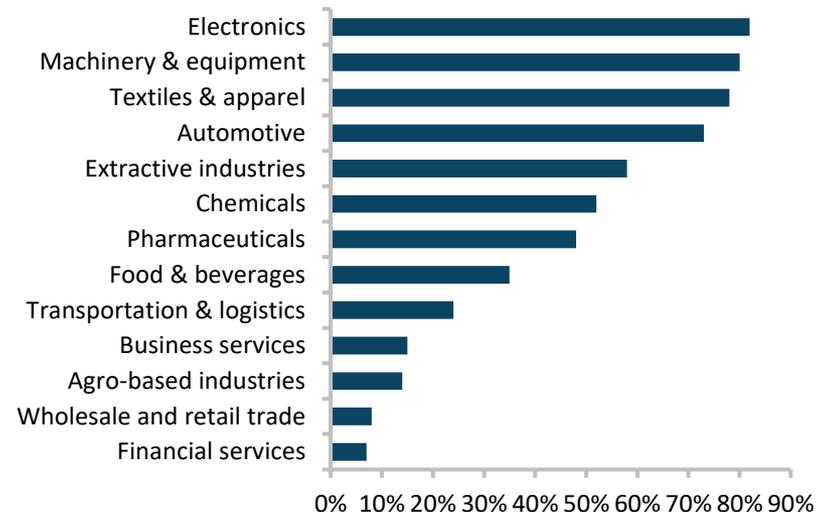
Sources: World Association of Investment Promotion Agencies (WAIPA), World Bank Group, 2020

iii. Development impact

Investment projects by this target group can contribute to export-led growth, employment creation and an upgrading process, which can also improve the resource and energy efficiency of the economy

- International experience shows, that the industry can make a major contribution towards employment and GDP
- Considering the strong export intensity, it can support the integration into global value chains and markets
- Due to significant spill-over and linkage effects, further industries are likely to benefit (e.g. electronics, metal, plastics)
- Suppliers of machinery can play a key role for innovation dynamics enhancing the productivity as well as energy and resource efficiency of their customers

Degree of internationalisation of selected industries (Gross exports as share of output)



Sources: UNCTAD 2021