

## **EXPORT-ORIENTED ECONOMY - A NEW MODEL OF DEVELOPMENT FOR THE REPUBLIC OF MOLDOVA**

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### **Abstract**

*The severe impact of the global financial crisis on Moldovan economy was accompanied by an increase in unemployment and fluctuations of inflation, reduction of foreign direct investment and external trade. One of the most important lessons of the global financial crisis of 2009 for the Republic of Moldova was accentuating the necessity to give up to the support of remittances, which determines that our economy is based on consumption and imports and should follow a qualitative model of growth. Consumption based growth, due to remittances is not qualitative growth and does not create jobs. That's why it is a vital necessity for Moldova to pass to a new path of economic growth, namely to an economic growth based on increase competitiveness.*

**Cuvinte cheie:** export-oriented, model, transition, financial crisis

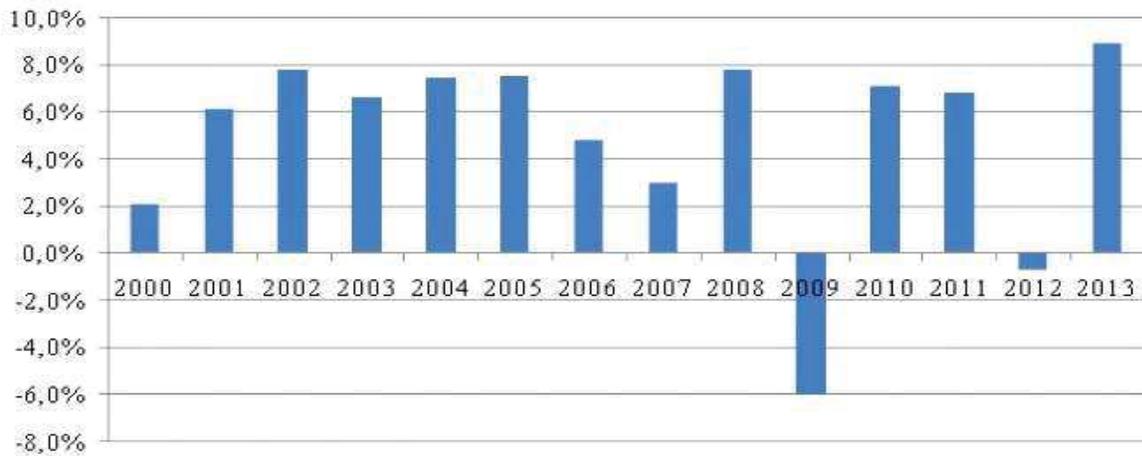
### **Introduction**

For the world countries it is already an axiom the need of transition from a consumption-led growth to one based on demand. But for countries such as Moldova situation is a little different, which until the present remittances are a substantial support for the welfare of society. Below we will present a brief analysis that will demonstrate this fact in order to argue the need for a stringent change for Moldova the development paradigm.

As a small open economy in which agriculture has a significant role, Moldova's growth performance has been strong but volatile. The economy recovered from the 2008-09 global economic crisis with average annual GDP growth exceeding 5 percent over 2010-2013. As a result, Moldova experienced the highest cumulative GDP growth, relative to the pre-crisis year of 2007, of all regional partners. However, growth has been volatile, reflecting vulnerability to climatic and global economic conditions. In 2010–11, remittances and investment fueled domestic demand, and growth in exports was strong. Real GDP grew by 7.1 percent in 2010 and 6.4 percent in 2011. In 2012, GDP contracted by 0.7 percent, as the economy was hit by a drought-induced contraction in agriculture (-22.3 percent) and weaker external demand due to

the Eurozone crisis. In 2013, growth rebounded, driven by a record harvest in agriculture, with GDP increasing by 8.9% in 2013. (Figure 1)

As shown in figure 1, during 2009 there was a stagnation of the Moldovan economy generated by the global financial crisis and the debt crisis in euro area. With the onset of the global financial crisis and poor economic conditions in Moldova's main foreign markets, GDP dropped 6% in 2009. In 2010, due to global and regional favorable economic conditions Moldova's GDP growth boosted to an impressive 6.9%, despite period of extended political transition and polarization.



**Figure 1. The evolution of Growth Rate of Republic of Moldova, 2000-2013, %**

**Source:** elaborated by author based on National Bureau of Statistics data

In 2012 after a severe drought, economy decreased by 0,8%, but the recovery felt in 2013 was strong when the rate of economic growth registered 8,9%, one of the highest in the region. However, high rates of economic growth registered in “good” years represent in fact correction effects, recovery from the crisis of economic boom before the crisis. The national economy develops according to a model based on *growth generated by consumption, imports and remittances*. Even if the Republic of Moldova had fluctuations in developing a stable economy, in 2013 it can observe that Moldova has passed over positive economic growth premises. (Table 1) From the above table we can state that consumer prices and the exchange rate of Moldovan leu (MDL) were relatively stable, due to the targeting regime of monetary authorities. The increase of the final consumption of households and public administration influenced by the increase of salaries and of the revenues of the population, were largely stimulated by the increase of remittances. Modest results of *investment activities* in the last 2 years, underline once again the need for reform. Thus, while in 2012 investments decreased by

4.1% compared to 2011, in the 1<sup>st</sup> half of 2013 there was an increase of only 1.5%. For the end of 2013 investments were 9% higher than in 2012.

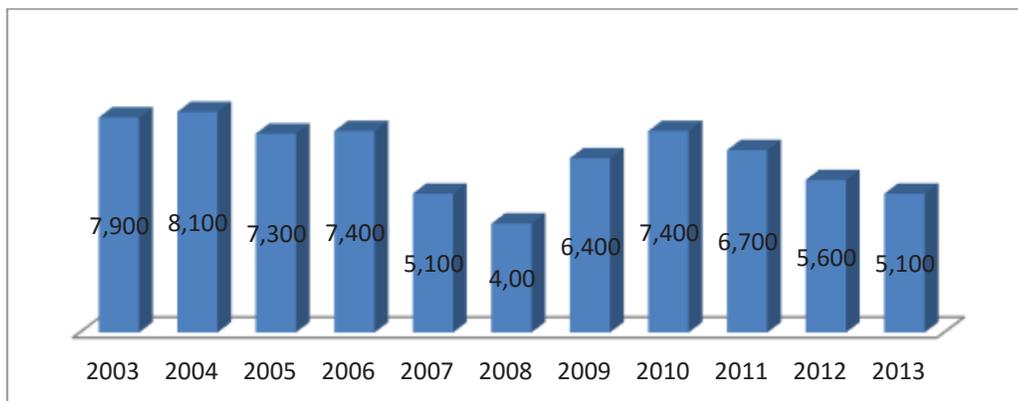
**Table 1. Selected economic indicators, Republic of Moldova, 2008-2013**

	UM	2008	2009	2010	2011	2012	2013
Gross domestic product (GDP) in current prices	MDL mill.	62,922	60,430	71,885	82,349	87,847	99,879
Real GDP as against the previous year	%	107.8	94.0	107.1	106.8	99.2	108.9
National public budget deficit	MDL mill.	-630.0	- 3,836.6	- 1,786.2	- 1,961.3	1,843.2	1,760.0
Agricultural output, % change, y/y	%	132.1	90.4	107.9	105.0	77.6	138.3
Industrial output, % change, y/y	%	101.5	78.9	109.3	109.5	98.1	106.8
Capital investment, % change, y/y	%	102.3	66.5	122.6	112.5	95.8	102.3
Consumer price index, year average,	%	112.7	100.0	107.4	107.6	104.6	104.6
Annual average exchange rate	MDL/US\$	10.3895	11.1134	12.3663	11.7370	12.1122	12.5675

*Source:* elaborated by author based on BNM and BNS data

The FDI stock accumulated in 2013 constituted 3668,3 million USD, formed by participation to the equity capital and reinvested earnings (2709,5 million USD) and intercompany lending— 958,8 million USD. The FDI stock began to increase considerably beginning with the year 2007, but registered very low rhythm of growth beginning with 2009 due to the repercussions of the global financial and economic crisis. The net inflows decreased in 2009 with a modest recovery in 2011 and in the following years. The main sectors that benefited from foreign direct investments are: financial intermediation, manufacturing industry, which registered a continuous growing share in total sectors that received investment from 2009 to 2012 years; wholesale and retail trade; real estate, renting and business services and electricity, gas and water supply.

The unemployment rate was between 4.0% and 5.0% namely below for the last few years. The economically active population was approximately 1235,9 thousand people, higher than in 2012 by 1.8 %.



**Figure 2. The evolution of unemployment rate in Moldova, 2003-2013, percentage values**

*Source:* elaborated by author based on data provided by National Bureau of Statistics

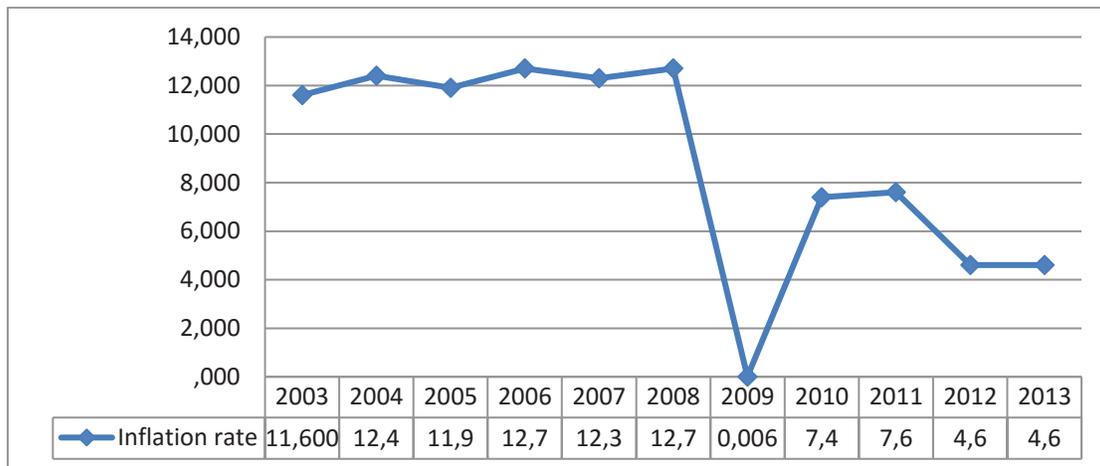
The data referring to *unemployment in the Republic of Moldova* from the figure 2 shows that from 2003 till 2006 more than 7% of total workforce were unemployed. The unemployment rate began to decrease in 2007 (5.4%) reaching the level of 4.0% in 2008. In 2009 Moldova's consequences of global financial crisis were the most severe, as unemployment rate increased by 2.4 p. p. and by another 1 p. p. in 2010. A relative improvement can be observed beginning with 2011 unemployment rate decreased by 0.7 p. p. in 2011, reaching the pre-crisis level of 5.1% in 2013.

The creation of the necessary conditions for maintaining the economic growth and a good functioning of national economy determine the acceleration of the inflationary process. The inefficiencies of monetary policies before 2009 promoted by NBM resulted in significant *price fluctuations and to inflation levels* higher than 10%, mainly from 2003 till 2009. Because of the long term prospects of the monetary policy, the effects were not seen immediately, the inflation rate registered more than 7% in 2010 and 2011, but in 2012 it reached the level of 4,6 % which was maintained also in 2013 as represented in the figure 3.

Due to the fact that the Moldovan Leu registered an appreciation in nominal terms, the *real effective exchange rate of MDL* appreciated considerable in relation to the currencies of our trade partners. This fact had a strong impact on the competitiveness of the Moldovan products on both foreign and local markets which aggravated the crisis even more.

Currently, in 2013 the exchange rate of the MDL depreciated in relation to USD by 8,2% in nominal terms and by 12,3% in relation to EUR. Main factors that influenced the modification of the exchange were the depreciation of main trading partners, mainly Ukraine and Russia, world parity of EUR against USD, increased foreign currency inflows, especially

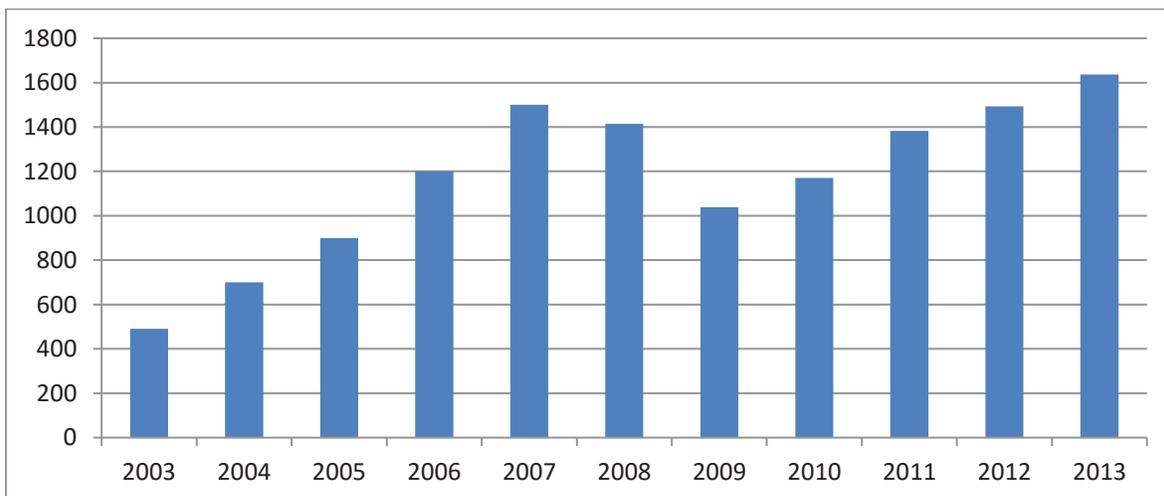
increased exports and remittances and the intervention of NBM on the currency market seeking to maintain the level of inflation within the limits.



**Figure 3. The evolution of inflation rate in Republic of Moldova, 2003-2013, n.v., y/y**

*Source:* elaborated by the author using the data provided by National Bureau of Statistics

*Remittances* presents the main engine of economic growth in the period of 2000's that triggered a significant increase of private and public consumption. Family incomes of immigrants who send money home is two times higher than families without financial flow from abroad. These families allocate more money in their budget to purchase consumer goods, paying off debts, repair or build houses. In addition, remittances had a great impact on macroeconomic stability in the Republic of Moldova. They have contributed to increased public revenues and supported the currency value. Remittances of Moldovan migrants working abroad reached in 2013, 23% of GDP (figure 4).



**Figure 4. Remittances flows to the Republic of Moldova, 2003-2013, mill. USD**

*Source:* elaborated by author based NBM data

The foreign currency transfers made by individuals through banks during 2012, amounted to USD 1.77 billion, or 23% of GDP. In 2013 remittances accounted 1637 million USD, up by 9.6 % compared to previous year. Remittances flow to Republic of Moldova have reached a historical peak in 2007 with a remarkable 36% ratio to GDP. In addition, there are remittances sent through informal channels – typically bus drivers or fellow of migrants going home – which are hard to estimate. Almost two-thirds of remittances arrived in Moldova in 2013, come from Russia.

Remittances are the most resilient foreign flows as opposed to foreign direct investment, exports, foreign loans and assistance. They have helped to increase the budget through VAT and import duties, to develop banking and financial intermediation services and increase official reserves. World Bank studies argue that remittances are important source of foreign exchange and helped to finance the trade deficit of Moldova since the late 1990's. Nevertheless, remittances could have a negative impact, although in most cases they lead to higher incomes for the beneficiaries. Higher income is often accompanied by a trend toward higher expenses, especially for consumer goods. Most consumer goods in Moldova, such as electronics, are not produced in the country, but are imported from abroad. This increased demand for imports often leads to an increase in local prices higher inflation and dependencies for imports.

*Foreign trade* is important for the Republic of Moldova for various reasons, especially given the relatively narrow local market and the insufficient internal basic materials and energy resources in order to cover the country's needs - both for intermediate consumption, like production of goods and services, and for the final production for household consumption, as well domestic, public administration and private consumption, which causes a high level dependence on imports. The structure of external trade is an important factor capable directly and indirectly influence not only on the general level of economic development, but and on quality of life of their citizens. In recent years, it is relevant to mention the increase of the weight of national products in the total volume of exports and the decrease of the volume of re-exports, which on the other hand proved to be more resilient to financial crisis.

First changes towards a new *economic growth path* can be observed in 2011 when the exports registered substantial rates of growth, higher than growth in imports. In 2012, in the context of the debt crisis in the euro area, commercial deficit led to an economic decline of 0,8%. Although, economic recovery from 2013 was determined mainly by an increase of consumption, an enhancement in exports is attested as their rate of growth exceeds the rate growth of imports, however the overall influence of net exports on GDP growth was zero.

Currently in the country exports to the EU the largest share (about 30%) comes to goods manufactured based on lohn production (electric cables, clothing, shoes, etc.). It finds also a rapid increase in the products manufactured in Moldova with a relatively high value added, the share of which, even not to high currently (20-24%), may become important in the future. In the last years, the structure of foreign trade of the Republic of Moldova by groups of goods was characterized by a tendency of changing in terms of quantity, but which remained at the same quality, in spite of trade facilitation regimes.

**Conclusion.** One of the most important lessons of the global financial crisis of 2009 for the Republic of Moldova was accentuating the necessity to give up to the support of remittances, which determines that our economy is based on consumption and imports and should follow a qualitative model of growth. Consumption based growth, due to remittances is not qualitative growth and does not create jobs. That's why it is a vital necessity for Moldova to pass to a new path of economic growth, namely to an economic growth based on competitiveness increase.

The brief analysis presented above indicates a robust attempt of the Moldovan economy to ensure a transition to a model of economic growth based on competitiveness increase, but far from being accomplished. The same like for our country, this conclusion is available for many other countries, that do not reoriented their economy toward qualitative economic growth, towards to an export-oriented development which would denote a high national competitiveness.

## References

1. Bureau of National Statistics of Moldova. [www.statistica.md](http://www.statistica.md)
2. National Bank of Moldova data. [www.bnm.md](http://www.bnm.md)