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## **NATIONAL ECONOMY OF MOLDOVA UNDER PRESSURE OF EXTERNAL AND INTERNAL THREATS**

Presently, Moldova is facing a crucial choice: or the country over the next decade will make a drastic modernization of its economy and society in general, or country will face a real danger of losing the security and independency. In this regard, there is a need to develop a scientifically reasoned plan of county modernization for the long term, as well as its positioning in the world community, taking into account national specificities and interests.

At the present stage the small economy of Republic Moldova faces set of problems that constitute a danger for its national safety and interfere with a sustainable development. The origin of these dangers is endogenous (internal). In global crisis conditions, these problems have deepened and intensified, due to high level of openness and integration of the Moldovan economy. At the same time world recession has caused both additional risks and problems which have considerably worsened a social and economic situation in the country.

Development of any country is strongly influenced by its geopolitical position. Moldova, due to geopolitical bordering limits (located at the crossroads of the different cultures alternative institutional systems of East and West) is situated in a zone of an attraction of various cultures and economic forces. This fact, objectively generates multiply and frequent changes of a direction of national development. While development occurs, the accents are constantly vary: from "Westernization", in different forms, to «east orientation», or in attempts to find the "own unique" model of development. In order to understand the present situation in Moldova it is necessary, at least in brief, to consider a track of its Post-Soviet evolution as independent state. The specificity of historical development of the small states is defined, on the one hand, by aspiration to independent development, and from another, - by pressure of the centers of forces. For Moldova such influential forces are Russia, USA and EU. Their multidirectional interests, substantially, interferes with development of a consecutive political policy of the country, and first of all, to the resolution of critical political and territorial issues (the Transnistrian problem). Almost two decades of separate existence across Dniester "Left side" and "Right side" has generated threats for integrity of the country: there were two rather independent sociopolitical and economic systems, with resisting imperious elite.

Long lasting political instability in Moldova, that has increased dramatically over the last year, after parliamentary elections and subsequent events (5-7 April 2009) inhibits meaningful socio-economic development and creates tensioned and unpredictable situation in the republic.

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In view of inconsistency and effectuated low efficient economic transformations - till now the Republic of Moldova continues to be in "a transit" condition. Experience of Moldova, under the remark of J. Striglitz, who visited republic in 2001, represents a bright negative example of how not to carry out the reforms.

The specific characteristic of economic transformation in Moldova is formal «advancement» to the reforms of the western sample at insignificance of their results. For example,

- 1) mass privatization campaign was not accompanied by growth of a production efficiency, economic and investment activity of "new owners»
- 2) non-transparent privatization provoked the gap between capital (concentrated in the hands of the oligarchs, banks, the administration of companies) and labor (employed for a symbolic salaries, often paid with considerable delay);
- 3) generated banking system is weakly involved in the rise of the national economy;
- 4) the stock market is inefficient, unable to provide companies with large resources;
- 5) national economy "opening" has unilateral character, integration communications are rather ineffective.

Moldova experienced the deepest and longest in the post-Soviet territory transformational crisis, reaching the Gross Domestic Product minimum in 1999 (34% from level of 1990). Moldova later, than other CIS republics regained its economic growth. From 2000 to the present day Moldova is considered the "poorest country in Europe." Moldova is an outsider among all post-socialist countries in terms of gross national product volume is located on the level of 1990. This is an absolute gap may become chronic for Moldova, even while maintaining an annual gross national product growth of 7% (maximum of 2000-2005). However, force majeure (natural disasters, the embargo imposed by Russia on alcohol and agricultural products from Moldova) have led to a dramatic drop in half, of the GDP growth in 2006-2008.

At the same time Moldova is experiencing low economic growth, that increases the danger for national security. Economic growth in Moldova is stipulated by foreign funds: it is based mainly on remittances of Moldova citizens that are working abroad.

The quality of economic growth in Moldova also suffers from lack of competitiveness of domestic goods and services, from mono structural exports, limited investment in fixed capital. Serious danger to the sustained development of the national economy represented by such events:

- deindustrialization and expressed agrarian dominant of economy;
- excessive dependence on domestic consumer demand on the scale of labor migration;
- development lag of regions of the country;
- insufficient development of market infrastructure;
- obvious "industrial raw materials" rather than "marketing" approach to the formation of product range;
- absence of modern technology and wholesale trade

The effect of these negative factors in the economic development of Moldova, despite the declarations of government and their efforts, not only persists, but constantly increase.

Despite of Moldovan agricultural economy dominant (here are employed nearly 34% of the able-bodied population, operating more than 1500 big economic agents and more than 292 thousand farms), the situation in agriculture is deplorable. Poor managed agricultural land privatization and liberalization campaigns led to severe disproportions and negatives, such as:

- reduction of the volume of agricultural production compared to the pre-reform period, decrease
- of the share of agricultural GDP (8.9% in 2008);
- preservation of ratio of commodity output at a low level (less than 40%), the remainder is used for intra-family consumption;
- food shortage, which is covered by imports, annually estimated at 300-350 million Euro;
- According to experts, domestic producers supply consumer demand for food products only at 52%;
- exclusion and substitution of products, which are traditionally made in Moldova (animal products, grapes, cucumbers, tomatoes) imported goods;
- agricultural products price growth and appeared speculators-middlemen, that fix monopolistically high prices for products;
- manufacturers experience loss of interest to produce labor-intensive and costly agricultural products;
- low competitiveness of agricultural products.

Occurred reforms produced destructive effect on the industrial potential of the country. Privatization of large and medium industrial enterprises, the separation of Moldova on the left-and right-sides led to the fact that the republic lost its industrial complex. Domestic industry is making a limited contribution to the production of GDP (14.5% in 2008), Only 25% meets the needs of the domestic market, while exports of industrial products is in 2,5 times less than its imports.

Over the last decade, the most dynamically developing industrial production field was production of construction materials, which is associated with construction "boom" occurring in the country. As for light industry, traditionally developed in Moldova since the Soviet era, biggest part of it (especially shoes and textiles) are exported, at the domestic market is occupied by imports or low-grade domestic products.

Until now Moldova has no system of testing and monitoring of conjuncture conditions in internal and external market of industrial and agricultural products. This system would allow making reasonable decisions related to the volume of export-import supplies, the promotion of products of local producers and increase of its competitiveness.

The situation in the investment field is also dramatic. Over the last decade, the level of investment in the national economy decreased in 10 times and is the lowest among CIS countries. Analysts name this situation the investment as a disaster, according to their calculations, the economic recovery in Moldova requires a doubling of investment. Far from perfect is the current structure of investment: population financial assets cover only a very small share (2%). Creating of the right conditions in the country (in particular, ensuring public confidence in the banks), according to experts, could bring to the national economy up to U.S. \$ 3 billion of public funds and from business that prefer to remain in shade. The majority of economic agents are not interested in long-term investment in research and innovation due to the high cost of financial risk.

During last years, situation with science and technological capacity of Moldova adopted the following negative tendencies:

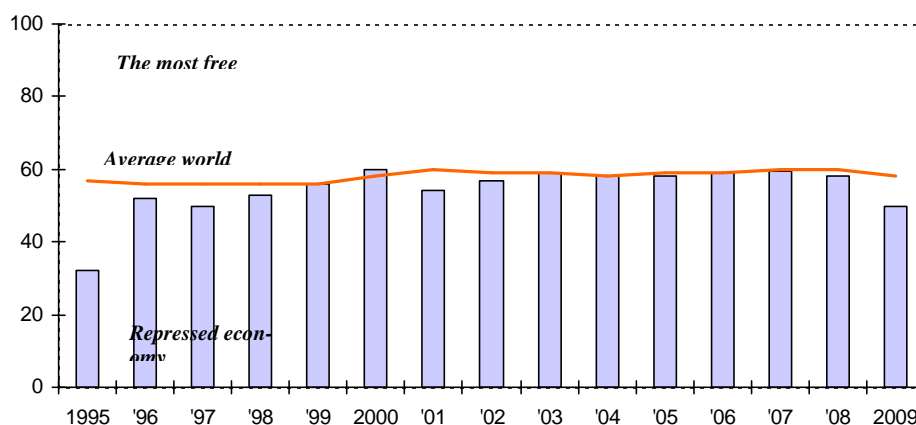
- reducing share of high-tech industry: science intensive enterprises are in significant proportion of loss-making enterprises;
- aging of fixed assets, it has reached a critical point (wear of the active part of more than 60% and only 3-4% annually updated);

- growth impairment of small innovative businesses;
- reduction of scientist in fields and certain types of production;
- reducing of the innovation efficiency;
- non effective distribution of funds from the state budget for scientific research. In Moldova, much of the allocated funds are spent on current expenditures (up to 96%), whereas in developed countries –on the fundamental and strategic research;
- lack of a single center of scientific and technical information, one of the important elements of infrastructure;
- lack of venture capital and real stock market.

Empirically verified, that the countries with greater economic freedom have economy higher growth potential and prosperity comparing with countries with a constrained economy. World rating of the index of economic freedom in 2009 *showed that from 167 rated countries, Moldova occupied 120 place, and among 43 countries of the European region - 39 place*<sup>1</sup>.

It is important to mention that during the last years the situation about freedom has essentially worsened: in a rating of 2005 from 157 countries Moldova was in the middle and occupied 77 place. The level of economic freedom in Moldova is fixed at the world average, and the economy in general is considered to be more free than not free. At the same time Moldova is nearly located the world's average level for the degree of "tax freedom", "free trade", "free enterprise". The worst positions are fixed in such fields as "investment freedom," "monetary freedom" and "freedom from corruption." The level of inflation is very high. Attracting of the foreign investment is very difficult, due to bureaucracy and corruption in the highest levels of authorities. During whole reforming process, the highest level of economic freedom was achieved by Moldova in 2000, 2003 and 2007, approaching the world average. However, in 2008 -2009 the dynamics worsened.

## MOLDOVA



Pic.1. Dynamics of Economy Freedom Index in Moldova (1995-2009)

The deterioration of mentioned index, especially in the monetary sphere, in the field of labor relations, property rights, as well as in the sphere of state intervention results from:

- The imperfection of the institutional system (benefits demand, widespread corruption and "shadow" agreements, the transformation of formal relations into informal, neglecting of the
- economic agents rights);
- Restrictive monetary policies in the country, in particular, demonetization of the funds due to ressure of significant transfers guest workers;
- Increased costs of food production, due to adverse natural conditions (drought, then floods).

Partially the reduction of economic liberalization can be explained by global financial and economic crisis. Even countries with high ratings of economic freedom worsened their indexes. It is quite natural: in times of economic shocks the government regulation of the economy is growing, unfolding the many campaigns that directly or indirectly are aimed against the free market system<sup>2</sup>. Among the most important characteristics of the national economy, along with the level of economic freedom is the degree of competitiveness that is also very important. It is first of all the *"ability of nation to create and maintain an environment that favors the profit-national enterprises, companies, and the enrichment and prosperity of the country's population"*<sup>3</sup>. As of competitiveness situation, according to *The Global Competitiveness Report*, a report prepared annually by experts from the World Economic Forum (WEF), Moldova is among the group of countries whose development is moved basic factors.

These include:

- 1) institutions (protection of property rights, ethics of government, corruption level, and judicial system independence);
- 2) infrastructure (transportation, communications, electricity supply);
- 3) macro economy (inflation, monetary policy, fiscal balance, and the level of government debt);
- 4) health and school education.

Moldova is clearly situated in development lag in such fields as competitiveness as "efficiency dilators":

- *High education and the professional training;*
- *the efficiency of market of goods and services* (the scale of state intervention, degree of economic openness, freedom of access of the companies to the market);
- *effectiveness of the labor markets;*
- *effectiveness of the financial market;*
- *technological readiness* (quick adoption of existing economy technologies to improve productivity);
- *market capacity.*

Moldova's Perspective factors of competitiveness growth are even worse presented:

- *qualification* (the ability of managers to effectively manage their companies)
- *innovations* (ability of companies to develop the most advanced products and technologies).

The negative dynamics of the competitiveness index is a serious threat for economic security: if in 2004-2005 Moldova took in the international rating 77 place, in 2007-2008 - 97 place, then in 2008-2009 - 95 place<sup>4</sup>.

The low level of national competitiveness is caused by several factors, among them are:

- not flexible labor market;
- artificially strengthening of the national currency and rising interest rates for loans;
- high level of inflation;
- lack of direct foreign investment;
- lack of innovation;
- undeveloped financial market;
- lack of major regional players;
- poor quality control and high levels of corruption;
- lack of well-grounded economic forecasts about competitiveness.

To break through the national economy in terms of competitiveness can lead the accelerated development of the sector of information and communication technologies (ICTs). This sector is currently the leader among the most dynamic sectors of national economy, its share in gross national product reached 10%. Moldova, according with the main indicators of ICT development among the CIS countries, took 4-th place, with leading Russia, Ukraine and Belarus. In the past six years, software exports grew in 10 times. This sector is becoming increasingly attractive to foreign investors. Moldova, according to experts, has a chance in the future to become the "Silicon Valley" of

Eastern Europe. Among the possible ways of improving of the competitiveness of Moldovan economy –many politicians and businessmen considered and the fact of joining the EU. It seems that the problem is deeper and should be largely resolved by Moldova, since we should speak about "package" of measures. Among them: the completion of the privatization campaign, implementation of structural reforms, attracting foreign competitors in the industry, which until now have been represented exclusively by national producers, ensuring compliance with national products with present European standards and observe "rules of the game" of European institutions. Due to the weak integration of Moldova into the global financial system the biggest strike from the global financial crisis suffered the real economy and standard of living. The most serious threat to national security are reviewed in the following areas:

**1. "Shock" of national industry:** it became possible, on the one hand, due to rising production costs (imported raw materials prices rise, energy resources), as well due to lower aggregate demand, more on investment goods and consumer durable goods. In connection with the financial instability and high credit risk decreases the demand for mortgage housing, which freezes the construction lots and also reduces the level of employment in the national economy.

**2. Strengthening of financial instability.** Due to the high external dependency of the national economy the demand for imported products in Moldova is reduced to a lesser extent than the demand for Moldovan products for foreign consumers. These imbalances lead to a further increase of the negative trade balance and public debt. For their payment is practiced overpriced money emission, which provokes the development of inflationary processes.

**3. Complexities of employment, unemployment, reduced abroad wages Re-emigration.** The return home of the guest workers is accompanied by a reduction in transfers and foreign exchange reserves of the country, increasing the tension on the national labor market, decreasing consumer demand, falling living standards.

Serious threats to security and development present the destruction of human potential, the direct loss of human capital. The country was in unfavorable demographic situation: birth rate for 1990-2008. decreased in 2 times, the death rate far exceeds the birth rate. In the past 10 years, the republic's population is decreasing annually by 8 thousand people (the number one large village). Moldova takes first place in Europe on the number of divorces (50% of the total number of marriages), a high level of migration of women (30 - 40% of the total number of emigrants), 300 thousand children live with one parent or no parents. Moldova is among the countries of Europe, where arose the acute problem of rapid population aging. Soon, every fifth inhabitant of Moldova will be over 60 years<sup>5</sup>. In the republic is pronounced the tendency of depopulation: for the years 1991-2009. Moldova's population decreased by 1 / 6 - from 4,3 to 3,6 million. The share of economically active population and employed in national economy is in constant reduce. The employment sphere is in critical situation. However, official statistics do not reflect the real picture of the labor market, the unemployment rate is clearly understated: in 2006 it was estimated at 2,9%, and in 2008 - 3,6%<sup>6</sup>. There is a high level of hidden and seasonal unemployment, especially in rural areas, it is difficult to find a job for qualified youth too. These facts forces the population legally and illegally to go abroad in search of work. For the republic is characterized excessive scale of illegal migration of labor, according to World Bank estimates, the number of migrant workers from Moldova – approx nearly 1mln. (about 30% of the working population), these are clear indications of a direct loss of human capital. As a consequence, there is a shortage of workers in the mass professions. Often, it is filled by immigrant workers from Turkey and Ukraine. The Moldovan economy is under the strong influence of money transfers, sent by migrant workers to their homeland. In total remittances (1.66 billion dollars, 40% of GDP) in 2008, won first place in the world. The volume of remittances to Moldova is comparable to the value of exports of Moldovan goods and services, it greatly exceeds the volume of direct foreign investment in the country and official help. Income from abroad allows to 40% of households in Moldova to survive. Thus, labor migration has become one of the mechanisms for the adaptation of society to the crisis of the national economy. Implemented "quasi reforms" caused impoverishment of the population: according with a number of indicators Moldova could be considered a region of social depression with a tendency of becoming a region of social distress. In the poorest segments of the population is placed population which according with commonly accepted indicators of educational and professional level, social activity and other indicators in the developed countries is considered to be the middle class. Minimal incomes are on the verge or below the subsistence minimum. Moldova's per head gross domestic product is (about \$ 1700 U.S. in 2008.) this level is the lowest in Europe. At the same time in the country today we can see a huge gap between rich and poor: 1% percent of the population owns 80% of the total wealth of the country. More than 1/3 of the population lives below the poverty line. Much of the population is marginalizing, loses motivation to business activity.

Among the serious social threats should be noted the following situations:

- inadequacy of the national budget to guarantee social security;
- introducing of the new system of the payment for social services, at prices that are disproportionate to the income of the population, limited opportunities for citizens to obtain quality education and other social services. Underestimated price of labor makes the reforms in the social sphere (health insurance, pensions) impossible.

As a result, the level of welfare of society - more than a low, the index of human development over the years of country transition worsened their position and went down in the international rating to 111 place<sup>7</sup>.

With all objective conditions, facing serious internal threats and global challenges, in conditions of high political tension in the country with a long delay was adopted a program of stabilization and economic recovery of Moldova for 2009-2011, which involves a set of measures to stabilize public finances, promote economic activity and ensure effective social protection in a crisis conditions.

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#### GOSPODARKA NARODOWA MOŁDAWII POD PRESJĄ ZAGROŻEŃ ZEWNĘTRZNYCH I WEWNĘTRZNYCH

W artykule akcentuje się konieczność podjęcia przez rząd Mołdowy działań w kierunku modernizacji gospodarki i społeczeństwa. Działania te są niezbędne, żeby nie stanąć przed zagrożeniem utraty własnej suwerenności. Powstaje zadanie opracowania planu modernizacji kraju w długoterminowej perspektywie, jak również pozycjonowania kraju w światowej wspólnotie z uwzględnieniem narodowej specyfiki i interesów.