

## THE ANALYSIS OF FOREIGN DIRECT INVESTMENTS CAPITAL FLOWS IN REPUBLIC OF MOLDOVA

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**Abstract.** *Acest articol analizează dezvoltarea economică a Republicii Moldova și cum aceasta este văzută ca o destinație pentru investițiile străine. Se remarcă faptul că factorii-cheie care contribuie la atractivitatea Republicii Moldova ar trebui să includă un mediu politic stabil, excluderea mitei, un climat favorabil de afaceri și o infrastructură bine dezvoltată care ar trebuie să fie implementată. De asemenea, se discută despre factorii ce îmbunătățesc și facilitează crearea unui mediu agreabil pentru investitorii străini dar și limitele care le provoacă statul în Republica Moldova. Autorul subliniază că Republica Moldova a creat o serie de politici de promovare a investițiilor, utilizând stimulente pentru investiții, oferind facilități deosebite investitorilor și un climat deschis și transparent pentru investiții. În general, Republica Moldova deși e considerată o țară mică cu anumite probleme economice și politice, oricum investitorii simt un anumit potențial în investirea acestei țări.*

**Cuvinte cheie:** Republica Moldova, Investiții Străine Directe, politici, promovare, servicii, mediu economic.

### INTRODUCTION

The purpose of this article is to assess and analyze the trends of Foreign Direct Investment (FDI) in Republic of Moldova, and examine its impact on both the local and global economies. The paper will also feature statistical data and individual insights to offer a comprehensive understanding of the subject matter. The significance of this article is to inform readers, particularly the youth, about the economic conditions of other countries beyond their own, and to demonstrate how a country's economic status can affect global affairs. The Republic of Moldova was chosen for the relatively existing economic growth, the promotion of investments and the encouragement of investors through several facilities and the attractiveness for foreign investors due to the consistent growth rates in recent years. The article will also explore Moldova's efforts to promote foreign investment and the agencies responsible for these initiatives. The article will end with a personal conclusion and additional resources for readers interested in the topic.

### THE MAIN CONTENT

Observing the World Bank analysis, Moldova is a small lower-middle-income economy. Although the poorest country in Europe, it has made significant progress in reducing poverty and promoting inclusive growth since the early 2000s. Moldova's economy has achieved a steady growth rate of 5% per year, primarily due to consumer spending and the injection of funds through remittances. The latter make up a significant portion of the country's GDP, with one of the highest proportions globally. Despite these economic advancements, Moldova still lags behind other European nations in terms of wealth, and remains one of the poorest countries on the continent.<sup>1</sup>

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<sup>1</sup> The World Bank in Republic of Moldova, source: <https://www.worldbank.org/en/country/moldova/overview>

The country's growth model, reliant on remittances, has become less sustainable due to declining remittances, low productivity growth, and a shrinking population. The pandemic, energy crisis, and refugee crisis caused by the Russian invasion of Ukraine have exposed the country's vulnerabilities. Moldova is heavily reliant on imports from Ukraine and Russia, making it vulnerable to supply disruptions. The government must find ways to mitigate the economic impact while maintaining long-term momentum, including transitioning to a new growth model. The European Council has granted EU candidate country status to Moldova, and the World Bank Country Partnership Framework for 2023-27 will support the country in its efforts to advance toward EU accession and transition to a new growth model.<sup>2</sup>

Table nr. 1. Country Context of Republic of Moldova (% of GDP)

MOLDOVA	2021
Population, million	2.6
GDP, current US\$ billion	13.7
GDP per capita, current US\$	5.231
Life Expectancy at birth, years	69.1

source: Elaborated by the author based on the data from: <https://www.worldbank.org/en/country/moldova/overview>

The 2022 World Investment Report by UNCTAD revealed that Moldova experienced an increase in Foreign Direct Investment (FDI) inflows from USD 150 million in the previous year to USD 264 million in 2021. The total stock of FDI reached USD 4.8 billion, equivalent to 35% of the country's GDP. The majority of FDI came from Romania, followed by Cyprus, Russia, and Ukraine, while the manufacturing, financial intermediation, and trade sectors were the primary beneficiaries. The IT sector is also gaining interest. The National Strategy for Investment Attraction and Export Promotion prioritizes seven sectors, including agriculture and food, automotive, business services, clothing and footwear, electronics, ICT, and machinery.<sup>3</sup> In order to evaluate its FDI throughout the last twenty years we can analyze the figure below:

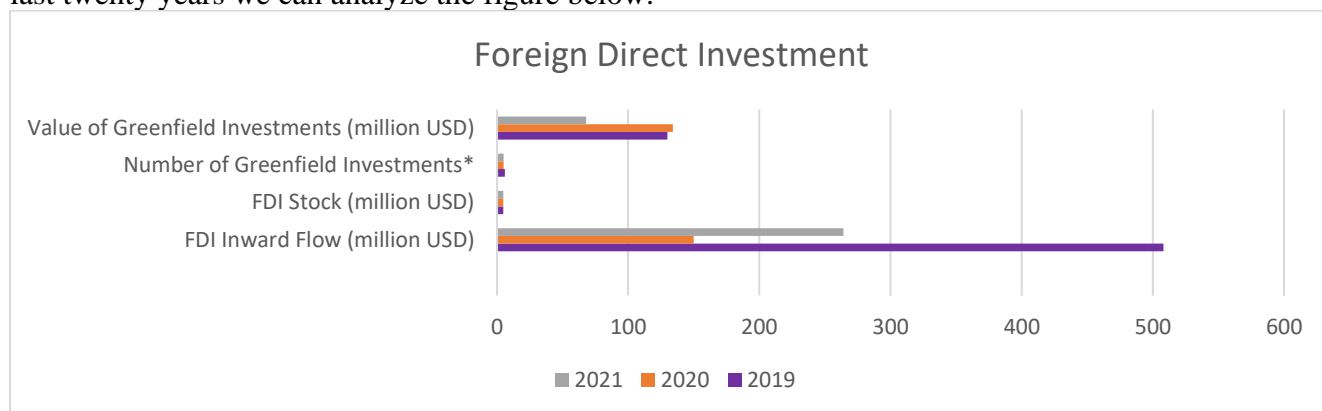


Figure nr. 1. Foreign Direct Investment (FDI) in Republic of Moldova between 2019-2021 (% of GDP)

Source: UNCTAD, Latest available data: <https://www.lloydsbanktrade.com/en/market-potential/moldova/investment>

Note: \* Greenfield Investments are a form of Foreign Direct Investment where a parent company starts a new venture in a foreign country by constructing new operational facilities from the ground up.

<sup>2</sup> The World Bank in Republic of Moldova, source: <https://www.worldbank.org/en/country/moldova/overview>

<sup>3</sup> Foreign direct investment (FDI) in Moldova, source: <https://www.lloydsbanktrade.com/en/market-potential/moldova/investment>

From the following figure we can conclude that starting with the year of 2019 and until 2021 the FDI inflows have been fluctuating and almost never were constant or with a steady increasing trend. Despite of this, Foreign direct investment in Moldova remains low, and the economic and political environment is not particularly attractive to investors. Foreign direct investment in Moldova faces various challenges due to a lack of a favorable economic and political environment, corruption, and administrative and judicial reforms. However, Moldova offers cost competitiveness, tax incentives, free economic zones, and permits foreign investors to repatriate funds. The country has rules for controlling investments in sectors important for state security, and potential investors need approval from the Council for Promotion of Investment Projects of National Importance. Moldova ranks low on the Corruption Perception and Index of Economic Freedom.

To attract Foreign Direct Investment (FDI), Moldova has several strong points such as a skilled and low-cost labor force, ongoing privatizations of state-owned companies, investor-friendly tax policies, and strong potential for agricultural production. However, there are also several weak points impeding FDI including high levels of poverty and a large informal sector, dependence on remittances from expatriate workers, political instability and social tensions, high levels of corruption, weak governance, clientelism, and the secessionist aspirations of Transnistria.<sup>44</sup>

#### Openness To, and Restrictions Upon, Foreign Invest

The country heavily relies on foreign trade and remittances for economic growth. Moldovan law grants national treatment to foreign companies, as the government considers foreign direct investment essential for sustainable economic growth and poverty reduction. However, the country has struggled to attract FDI due to a shortage of qualified labor and the emigration of skilled Moldovan workers.

In 2016, Moldova ratified its Association Agreement with the EU to foster closer political association and economic integration with the EU. The DCFTA, which is a part of the Association Agreement, eliminates customs duties on industrial and agricultural products and further liberalizes the services market. The agreement aims to address trade barriers and economic governance reforms, enhancing transparency, competition, and EU product standards. Due to Moldova's small economy, the country depends on a liberalized trade and investment approach to increase exports of goods and services to the EU.

Moldova, a member of the WTO since 2001, has signed various bilateral and multilateral free trade agreements, including the EU DCFTA, CIS Free Trade Agreement, Central European Free Trade Agreement, and Free Trade Agreement with Turkey. After signing the DCFTA, Russia imposed politically motivated trade bans on Moldova's exports, leading the country to expand and diversify its exports outside of Russia. The EU has become Moldova's largest export destination, accounting for more than 60% of its exports. The invasion of Ukraine by Russia in February 2022 had a negative impact on Moldova's traditional trading partners and routes, leading the country to seek increased cooperation with the EU to eliminate import quotas on certain goods to compensate for lost trade. As a result, trade with Europe is expected to increase.

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<sup>44</sup>Source data: <https://www.loydsbanktrade.com/en/market-potential/moldova/investment>

<sup>4</sup>INTERNATIONAL TAX REFORMS AND SUSTAINABLE INVESTMENT by 2022, United Nations: [https://unctad.org/system/files/official-document/wir2022\\_en.pdf](https://unctad.org/system/files/official-document/wir2022_en.pdf).

The Moldovan government has identified seven priority public sector areas for development and reform, including education, access to financing, road infrastructure, business regulation, energy efficiency, justice system, and social insurance. The government is committed to making the economy more capital-intensive, sustainable, and knowledge-based, and has published an Action Plan for 2020-2021 to implement outstanding AA/DCFTA requirements. Additionally, the government has started working on a new National Action Plan to accelerate the country's development.

#### Limits on Foreign Control and Right to private Ownership and Establishment

The key points which investors are considering:

1. Foreigners are prohibited from owning agricultural or forest land in Moldova, but can own all other forms of property including land plots under privatized enterprises and land designated for construction.
2. Foreigners can only become owners of agricultural or forest land through inheritance and can only transfer the land to Moldovan citizens.
3. The only option available to foreigners who wish to use agricultural land in Moldova is to lease the land.
4. Moldovan law provides national treatment for foreign companies in most respects.
5. The Law on Investment in Entrepreneurship prohibits discrimination against investments based on various grounds.
6. Companies registered in questionable tax havens are technically prohibited from holding shares in commercial banks.
7. In November 2021, Moldova passed a law establishing a screening mechanism for strategic investments in critical industries and assets.
8. The law requires prior approval from a governmental council chaired by the Prime Minister for any strategic investment.
9. The law restricts investment opportunities for investors from offshore zones, those convicted of certain crimes, involved in money laundering and financing of terrorism, or known to have links to foreign authorities that pose a risk to national security.
10. Certain forms of legal organizations and activities in Moldova require a minimum capital investment.<sup>5</sup>

## CONCLUSION

In conclusion, after an analysis of foreign direct investment (FDI) trends in the Republic of Moldova I concluded its impact on local and global economies. Despite being one of the poorest countries in Europe, Moldova has made significant progress in reducing poverty and promoting inclusive growth. The country's remittance-based growth model has become less sustainable due to declining remittances, low productivity growth and a shrinking population. However, the government is taking steps to mitigate the economic impact and transition to a new growth model. UNCTAD's World Investment Report 2022 revealed an increase in FDI inflows to Moldova, mainly from Romania, Cyprus, Russia and Ukraine, with the manufacturing, financial intermediation and trade sectors being the main beneficiaries. Moldova offers cost competitiveness, tax incentives, free economic zones and allows foreign investors to repatriate funds. However, it also faces challenges such as the lack of an enabling economic and political environment, corruption and weak governance. The significance of the article is to inform readers, especially young people, about the economic

conditions of other countries beyond their own and to demonstrate how a country's economic status can affect global business.<sup>5</sup>

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<sup>5</sup> 2022 Investment Climate Statements: Moldova, source data: <https://www.state.gov/reports/2022-investment-climate-statements/moldova/>