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FOFEIGN DIRECT INVESTMENTS AND THEIR ROLE IN ANTE- AND POST CRISIS DEVELOPMENT – SOME REFLECTION ON THE REPUBLIC OF MOLDOVA

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Foreign direct investments are the main tool of economic globalization. They represent necessary fuel for sustainable economic and social growth in the developing countries. Besides obvious capital formation aspect, FDI contribute to job creation, increase level of salaries and bring managerial skills and know-how to the host economies. However, the positive impact of FDI on recipient countries is not so indisputable. Some researchers even speak about recent "FDI-led" crisis. Some aspects of the controversial nature of FDI will be presented in this paper.
Key words: Foreign Direct Investments (FDI), economic crisis, capital flows, balance of payments, volatility, liberalization, economic development.

Due to the strong support from international organizations (IMF, World Bank) and their promotion, FDI became one of the main points of interest for developing countries. Governments compete to attract more foreign capital flows by facilitating FDI access on internal markets. Among most popular measures for FDI attraction are so-called tax holidays, elimination of labour and environmental regulations etc. At the same time, the effects of these decisions for sustainable social and economic development of the countries may be seriously damageable.

Lower tax rates may significantly reduce budget revenues and affect the implementation of social programs and payment of budgetary salaries.

Environmental deregulation as a result of "environmental dumping" may attract hazardous productions to the host countries, which will be harmful for soil, water and health of the population.

Reduction of labour standards can also have negative long term effects, as it is always much easier to reduce requirements than to ask for expensive labour protection mechanisms and measures.

These and other potentially negative effects of FDI were broadly analyzed in scientific literature (Carkovich and Levine, 2002 [1]; Dutt, 1997 [2]; Lensink and Morrissey, 2006 [3] and others). Short-term effects of the "hot" money may cause too significant costs in future.

What is absolutely clear in this context is that the role and impact of FDI on host economies may vary depending on current economic conditions, government decisions, corruption and other issues. It is also very likely that FDI will demonstrate high volatility during the unusual economic condition, as, for example, global financial or economic crisis. This volatility is definitely less harmful then the volatility of other sources of capital [4], but still remains a weak point of FDI as a development measure.

In 2008 the global economy faced one of the most serious and contagious financial and economic crises. The roots and consequences of this crisis were very specific, but also similar to previous economic crises, which took place during the XX or XXI century.

The 2008 crisis was not an unexpected one. It was predicted in many scientific works. Fred Foldvary in his paper "The Depression of 2008", published in 2007, but based on the 1997 paper, had predicted the crisis and even demonstrated that it will take place in autumn 2008 [5]. According to many specialists, the first stage started at the real estate market of the USA. F. Foldvary explained this moment through the theory of economic cycles. A deeper analysis was proposed in the New-York Times article by Tyler Owen [6]. He argued that there 3 reasons of the 2008 crisis:

1. Enormous growth of wealth which has transformed in investments. So, the growth of investments was one of the crisis factors.
2. Exaggerated risks of investments due to the excessive investing.
3. Regulation, governing and reduced control from the state institutions.

The very first argument is extremely important to discuss, as it refers to one of the most powerful instrument of the modern economy – FDI, which are promoted as one of the most important tools in sustainable economic development.

The World Bank publication [7] in 1994 stated that "Malaysia and Thailand are the FDI-led miracles in east Asia". In 2001 David Woodward in his book proposes to accept that "Malaysia may also have experiences the first FDI-led financial crisis; and the Thailand had the second crisis, after that of Mexico, in which FDI was a significant contributory factor" [8].

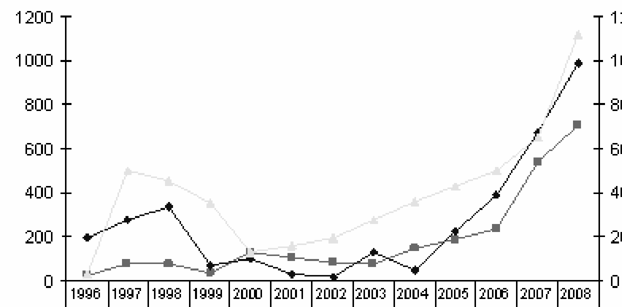
We may hardly presume that FDI solely may cause financial crisis. But some concerns about FDI contributions to country's pre-crisis situation and crisis development effects still exist.

The main assumption is based on the idea that FDI have important and really powerful contribution to the balance of payments. FDI impact on import and profit remittances can be greater than the impact of FDI inflow itself, and thus, the overall impact on balance of payments can be negative. Of course, foreign companies can't be solely responsible for the current account deficit, but their activity can be an important factor stimulating the crisis and crisis effects. This idea doesn't necessarily lead to a conclusion that countries do not have to attract FDI or to make barriers for the foreign capital inflows to national economies. This idea underlines the fact, that FDI are not so simple and unequivocal as economic phenomenon.

We have analyzed certain official statistical data of the Republic of Moldova for the period 1996-2008: dynamics of foreign investments in national economy, current account deficit and current transfers (debit). Interesting findings can be deducted from the figure, presented below (figure 1) [9].

It is clearly demonstrated that direct investments in national economy are strongly correlated with current transfers (outflows). Debit current transfers increase significantly with the investment growth and vice-versa. Unsurprisingly, taking into consideration previous statement (as current transfers influence balance of payment), direct investments have same evolution as the balance of payment or current account.

Figure 1



	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Direct investments in national economy	23.74	78.74	75.51	37.89	127.5	103.4	84.05	73.75	146.2	190.7	233.2	539.3	707.6
Current account deficit	191.8	274.8	334.7	68.16	98.19	26.79	19.8	130.2	46.13	225.8	388.8	673.8	987.4
Current transfers - Debit	2.78	50.01	45.51	35.4	13.05	15.92	19.29	27.81	35.8	43.22	49.99	65.24	111.5

Figure 1. Direct investments in national economy, current account deficit and current transfers (outflows) in Moldova, 1996-2008

Data source: Balance of payments, National Bank of Moldova [10]

The figure 1 illustrates the important fact – FDI can really affect the balance of payment. As we know, current account weakness had a particular significance for Mexican, Latin American and Asian countries during the crises.

This impact of FDI on balance of payments can be explained by:

- growing FDI flow increases FDI-driven profits and thus, contribute to current transfers,
- foreign investors contribution to fixed assets import.

So, the obvious reduction of FDI during the economic crisis, which is happening because of the risky ambience for foreign investors, is not the only bad symptom associated with FDI during these crises. FDI impact on balance of payments before, but also after the crisis begins can play crucial role for country's situation and its international position [9].

It is broadly accepted FDI are better source of capital than loans, because they bring technology, know-how and other positive effects. At the same time, loans are payable according to a certain scheme, but FDI volatility depends on investor's decisions. This is an unpredictable and complicate framework for governments, as they never know which the investor's "rescue" measures are. The reduction of FDI inflows "per se" is a negative tendency, but the consequences are even more dangerous.

If investors decide to withdraw their capital as a result of economic or financial instability, it may cause first of all currency depreciation due to the excessive demand for foreign currency. The crises are usually accompanied by the significant reduction of remittances to the developing countries also. As a result of both we may expect a reduction of purchasing power and increasing inflation, which will lead to the decrease of production of non-export goods. And the production slowdown will, probably, conduct to the reduction of jobs. So, in the conditions of crisis, FDI or the capital outflow connected with them is a powerful factor of keeping a stable economic and social situation. In this context, stimulation of reinvestment of profits can become an essential tool, because in that case the negative crisis-driven FDI effects will be limited on the reduction of inflows without excessive capital outflow and its impact on the balance of payments.

What also we may expect as a result of the crisis and growing competition for new FDI is the considerable lobbying for developing countries for further liberalization of market access. At the same time, inadequate regulation and lack of supervision at the time of the liberalization may play a key role in explaining why deregulation and crises are so closely entwined.

Empirically, in 18 out of 25 cases of banking crisis studied by Kaminsky and Reinhart, 1999, [11] financial liberalization had occurred some time in the previous five years. It is interesting in this context to analyze the structure of FDI in Moldova (figure 2).

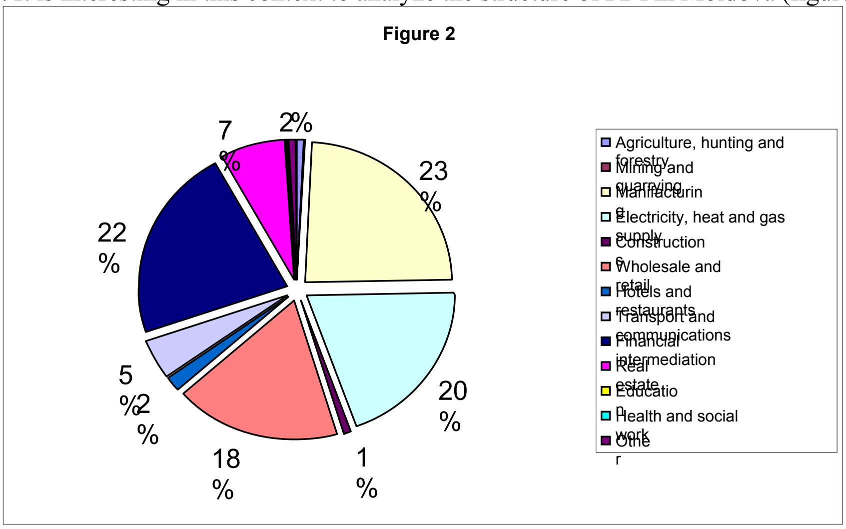


Figure 2. Foreign investments in the statutory capital of enterprises of the Republic of Moldova from the moment of registration by economic activities for the end of 2008, Mil. MDL

Data source: National Bureau of Statistics of the Republic of Moldova [12]

We may suppose that economic activities that attracted more FDI are more preferable for foreign investors: financial intermediation (22%) or electricity, heat and gas supply (20%). Investors will ask for more liberalization and more favorable conditions for them. This already happened in Moldova and since January 2010 tariffs for heating and energy will be established by the independent agency (ANRE), not by the local authorities, as before. The governmental role in these conditions is to keep investors interested, but not to exaggerate with liberalization and promotional measures which may cause problems in future. A special concern in this sense is arising because of the financial intermediation sector, which passed through the last economic crisis almost without significant losses. It is a signal to preserve the regulatory framework in the same direction.

As a conclusion, we can mention that FDI represent an important factor for the economic and social development of the countries, but their multidimensional nature is very complicated. FDI as a chemical substance without dangerous additives positively contribute to different aspects of human activities. However, external or internal negative factors can radically change their impact.

The policy measure of the recipient countries must correspond to the current situation, its challenges and should be updated promptly. It is highly probable that the slowdown of FDI flows or their withdrawal will lead to a significant current account deficit, which may cause serious economic problems.

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ПРЯМІ ІНОЗЕМНІ ІНВЕСТИЦІЇ ТА ЇХ РОЛЬ У ДО- ТА ПІСЛЯКРИЗОВОМУ РОЗВИТКУ ЕКОНОМІКИ (НА ПРИКЛАДІ РЕСПУБЛІКИ МОЛДОВИ)

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Прямі іноземні інвестиції є основним інструментом економічної глобалізації, вони підживлюють економічне й соціальне зростання країн, що розвиваються. Окрім очевидного внеску у формування капіталу, ПІІ вносять вклад у створення робочих місць, підвищують рівень заробітної плати, сприяють появі у країн-реципієнтів ноу-хау та інновацій у системі управління тощо. Проте, позитивний вплив ПІІ на країни-реципієнти неоднозначний. Частина дослідників стверджує, що прямі іноземні інвестиції є причиною кризи. У статті представлено деякі аспекти суперечливого характеру ПІІ.