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Moldavan Economy on the European pathway

1. New enlargement of EU: lesson for Republic of Moldova. General trends.

Starting with May 1st 2004, EU integrated ten more countries that had received the "graduation diploma" of the exam for joining Europe on general basis. For Poland, Lithuania, Lithonia, Estonia, Hungary, Czech Republic, Malta, Cyprus, Slovakia, and Slovenia the harvest of that "marriage" of political and economic interest between the East and West, designed over a decade ago, will come out shortly. In five years from now utmost, the new club of EU intends to become world's most competitive power, being fully politically and economically integrated, able of opposing the pressure of other big actors on the international arena. Having this in mind, taking into consideration Republic of Moldova efforts in the European integration process, more economic analysts are tempted to question what will be the economic outcome for Republic of Moldova as a result of the new wave of EU enlargement..

First of all, there is the risk decline in the trade exchange and consequently decline in the export revenues. That might be as a result of the elimination of the Moldovan goods from the common market or of the introduction of barrier tariffs on the trade with non-EU members. Another negative effect could be the price growth for some goods imported from the new EU entrants, which will align their prices to the existing EU prices. As a result of that expansion persists the risk of elimination from the market of some uncompetitive companies, fact that will lead to the unemployment and crime rate growth. Afterwards the free migration of labor force to these countries will become difficult, because some of them are struggling with constant shortage of jobs and a high unemployment rate.

Starting its journey towards a free market economy at the same time as the Baltic countries, countries that were integrated into the Soviet Union economy to a greater extent, Republic of Moldova did not know how to exploit its political independence to obtain an economic independence. Instead it remained behind the integration process for an uncertain period of time. That period of time actually means millions in lost investment for Moldova, that will be redirected towards countries with a more certain business climate, with strict European laws, and very important, obeyed. Republic of Moldova is being considered by many international and multinational organizations as one of the poorest and corrupted countries of Europe. Moldova is ranked last among European countries with a 230 Euro per capita annual income, while the average per hour remuneration is 0,3 Euro. Poverty has reached unprecedented levels, with over 40% of the population living below the poverty level.

How was it possible to have such a discrepancy, among countries that have commenced having almost same chances? Who and where had made the mistake, bringing Moldova to heavily lag behind Estonia for example, a country with a population three times

smaller that Moldova's and with far fewer natural resources. First of all, business community and event the politicians, the blame is to be put on the political elite that was the obstruction of the development rather than the reform coordinator. Nothing in Moldova could guarantee the irreversibility of reform, because the political elite did not manage to get rid of the doubling of its foreign policy. Situated at the endpoints of two power poles, between Moscow and Brussels, it could not understand that the too long pleasure of sitting on two boats could lead to internal disintegration.

Those who succeeded the power were not able to identify and apply one strategy, if not efficient, that at least the right one. Lack of willpower, substituted by a hope that the things will solve by themselves, without endangering the seats. Economic strategies, if they could be called so, have promoted inefficiency and the building of a "black zone" of the economy, instead of economic prosperity, productivity and investment. Governments that replaced each other were more concerned with promoting of a social policy exaggeratedly protective without financial coverage with downwards pressure on the state budget, and did not encouraged businesses to invest and create more jobs.

The effects of the lack of willpower for the application of reform will have a long-lasting effect. An important number companies from various sectors were protected by the Government form privatization. The infrastructure is ruined, the legislation has a decorative significance, and the level of foreign investment, that is around 3% of the GDP, is incomparable with that of Poland, Czech Republic of Hungary where it is about 40% of the GDP. Undoubtedly, such a small and poor country as Moldova, with a double standard legislation, politically unstable and ambiguous, is of no interest to international finance and few if any foreign investors find it attractive to invest in Moldova.

From the point of view of opening to foreign direct investment to Moldova, many important years have been lost. Many years after Moldova gained its independence were marked by nostalgic sentiments for Soviet Union, characterized by slogans like "we do not sell our country". During those years Baltic countries were heavily privatizing state enterprises making its investment climate attractive to big international corporations. Failure of the privatization program, unwillingness to invest into infrastructure, aggravated by lack of support for efficient sectors of the economy, combined with heavy subsidies for non-performing sectors and legal chaos, kept Moldova away from European integration.

In order to accelerate European integration, certain rules have been developed, but few obeyed them. The situation persists, and business community is frustrated by the double standard approach that the government has.

With Government still holding the majority of the stake in the Moldovan economy, Moldovan economy is balancing on the default edge. Lack of democracy has forced the Council of Europe to include Moldova on its watch list. Political and social instability that dominated Moldova over the last decade, together with lack of experience and skills in managing the national economy through coherent and adjusting policy, are the factors that determined for the most part lack of significant successes.

At the same time, it should be understood that the responsibility is not to be attributed exclusively to the government institutions, which are by definition weak, inefficient and lack financial and human resources. A big part from the responsibility lies on the civil society, who is ignorant and static. A certain private initiative, as it has been demonstrated by the economic liberalism scholars is the prerequisite for a society's wellbeing. In the place where the state is helpless, corrupted and incapable, it should be relied first of all on its own capacity. Therefore, more action, perseverance and personal courage, would be the ingredients of the Moldovan success as a society, to assure Moldovan fusion with the European nations on general basis.

2. Economic policy of the European integration: costs and benefits

Previous enlargements of EU have gained the attention of the politicians, economists, bankers, diplomats etc. The significance for regular citizens was minor – few in Italy or Germany have shown their concern when Greece and Portugal joined the EU, and few were concerned about the consequences that could be triggered by their adherence to EU. In the case of the May 1st 2004 enlargement and the one scheduled for 2007, the social implications in EU countries have dramatically changed; an open concern replaced the traditional Europeans' ignorance. It could be noticed even an exaggerated fear linked to the financial costs resulting from a too big enlargement of EU towards East and to the possible social and political consequences (rising crime rate, new waves of alien culture migration, cheap labor force etc). Even in some central and east European countries that in the early nineties were overwhelmed by a sincere European enthusiasm, the tendency is the diminishing social support for EU enlargement.

The results of the current enlargement will influence the Moldova' chances to be approved in the future by EU, as well as the extent to which the idea of European integration will be endorsed by the constituency. If the present enlargement will prove to be too costly, the prospects for Moldova to be approved by EU will diminish, because culturally Moldova is more alien to EU than Romania or Lithuania. At the subconscious level of the European society Moldova, even if present, continues to be fully associated with Russia. The citizens of Europe keep alive their memories of the Cold War towards that "Extreme East of Europe" as it is Moldova.

Even though EU will be able to overcome relatively soon its hesitation about Moldova, the integration will be able to happen only if the European idea by itself will be supported by the political elite and by the civil society of Moldova and if it will be clear that Romanians, Estonians, Bulgarians and so on do not become second class citizens. An integration support could come only after the mutual understanding between the positive and negative consequences, including the likely economic outcomes, immediate and perspective, that will accompany the integration process.

Obviously the cost/benefit analysis is an uncertain approximation of the numerous circumstances that will come into play should integration become a reality. The

integration process for the new entrants should be classified into two large categories: those belonging to the association stage, that could be quantified and those belonging to the joining stage. They both assume direct effects (the elimination of the trade barriers, common industrial and competition policy, implementation of the Common Agricultural Policy of EU in agriculture, access to the structural funds) and indirect (reorientation of the trade, industrial and agricultural reorganization, implications of the regional development and implementation of the new monetary policy)

European and Moldovan economy in short term run

Comparison of the tendencies in the EU economies with Moldovan ones is important for the evaluation of the intensity and duration of the necessary efforts for the convergence between the income levels and standards of living in European countries.

Moldova meets the necessary conditions for a more sound economic growth than the average for EU countries. That is due to the extremely small size of the economy to which Moldova has downsized as a result of the transition process of the 1990's, and the room for an expansion. A faster growth could be sustainable only with the condition of a structural modernization and a technological intensification of the economy. Aside from the strong growth, there is room in Moldova for the growth of financial funds and technology inflow. Increase of the capital per labor unit and more efficient use of the production factors, the structural convergence of the domestic economy with the European will require the actualization of the institutional level and revision of the traditional economic policy.

Moldovan economy is small, and small economies accept the prices established on the international markets without having the necessary economic power to influence them. Moldova's share in the global imports and imports is 0,02% and 0.03%. Moldovan economy is one of the most open economies of the world to the international trade, therefore very sensitive to the external positive and negative fluctuations (the export in January-June 2004 was 45% of the GDP for the entire year, level similar to Taiwan, Slovenia, Switzerland, South Korea) Trade balance is almost entirely dependent on the market changes of its traditional trade partners (particularly Russia and Ukraine), that represents the main destination of the Moldovan exports. The financing of the Moldovan trade deficit a significant importance has the remittances sent by Moldovan citizens working abroad. The National Bank of Moldova estimates that remittances constitute about 13% of the GDP although unofficial estimate it to be at roughly 45%.

Moldova will not be able to significantly influence the economic situation in EU in the short run or upon eventual access. At the same time EU could crucially influence the economic situation of Moldova, because the European countries absorption potential is huge, compared with the currency needs and production and export capacity of Moldova. Even as an agricultural producer that on a medium term has big competitive potential, Moldova will not be able to destabilize large segments of the European markets. It is less clear the impact that Moldova could have as a export of cheap labor force, because there is no accurate data about the actual level of emigration, to be able to estimate the

emigration that could have place upon the opening of the borders for labor force. Some recent studies estimate 335.000 citizens of the new ten entrants will emigrate to EU in the first year of accession. By 2030 the number of emigrants could reach 4 million people. Another estimation forecasts 2,4 million people. Both scenarios assume that a half of the emigrants will come back to their countries.

Macroeconomic forecast for the European area

For the period until 20120 for the Western Europe it is forecasted a 2,25-2,5 annual growth, which is not much different from the one from the last 20 years. The GDP growth in the Central and East European countries is expected to be at 4,5 % annually for the period 2003-2010. Taking into consideration the fact that Central and East European countries will have on the average a GDP that will not exceed 10% of the EU's, we can conclude that until 2010 EU will be composed of 27 countries will grow at a steady rate of 2,7-295 % annually. So far it is reduced the probability of an enlargement that would significantly influence the aggregate GDP growth of EU (as it would be the simultaneous accession of Turkey, Norway and Switzerland) But even if these "modest" growths of bellow 3% of the EU economies actually means additional revenues of 200 billion dollars, equivalent to 130 Moldovan GDPs.

The unemployment in the EU countries is higher than the equilibrium level ("annual unemployment rate"), that will allow that until 2010 to keep a low inflation. Public debt in the EU countries will see a downward movement, from 63% to 56% of the GDP. At the same time in Central and East European countries the public debt will have an upward movement. For the European Union a major source of uncertainty is the evolution that will followed by the labor productivity. It is assumed that EU will reduce its discrepancy from US, anticipating a 2% improvement tendency of the productivity growth rate of labor for 2004-2010. With the condition of intensification of the investment process during that period of time, the productivity of labor in Moldova has a greater growth perspectives than the EU average.

The European currency will gain probably more comparing to the US currency, even if US will succeed to exit the Persian Gulf. US continuous presence in the Gulf might have negative consequences for the US economy, due to its already the biggest trade deficit and public debt in the world. Euro will stimulate the intra-European trade more than the EU trade with outside world and a real appreciation of Euro could even damage the European exports. Currency risks in EU countries have disappeared once the national currencies were replaced with Euro, similarly the transaction costs have significantly gone down. The initial success of Euro as a currency for international transactions was not followed by a growth of its attractiveness as an international investment instrument. Although a negative evolution of the US economy could "cure" that state of affairs and Euro could become more attractive for institutional investors. Its share in the world's economy will grow, and if a major economic crisis will not take place in US, in the short run the European currency will stay to be the second international currency after the US

dollar. Regardless of the US economic situation, in the long run, when the European financial markets will become less fragmented, the position of the common European currency could be consolidated as much as Euro to acquire in the world's economy an equal importance with the US dollar.

Application of the convergence criteria in the European integration perspective

Upon the entry of the Central and East European countries in the Economic and Monetary Union a convergence of prices and real salaries to the general EU level will take place. That could trigger a "migration" of European firms established in the Central and East European countries to countries that for at least a few years will be in a non-EU member status, possibly Moldova. On the other hand, Euro zone will lower the interest rates in the new member-states from Central and East Europe, and this will be intensified by the internal investment process of those countries.

Financial and economic convergence of the new members will be necessary to enter the EU monetary system. But the costs at the macroeconomic level, implied by the convergence are estimated to be lower than the benefits at the microeconomic level which Central and East European countries will receive upon joining the EU monetary zone. It is likely that the new criteria for convergence will be modified in the near future, as a result of the difficulties encountered even by the most prosperous economies such as Germany or France. Regardless of the modification and upholding of the current criteria, joining the Euro zone will benefit not only the convergence of the European countries towards similar economic and financial levels, but also towards models of more appropriate economic development.

There are relatively few scenarios for Moldovan economic growth that would be constructed on the basis of reliable econometric models. The construction of such scenarios is impeded by the lack of reliable statistical data, as much as by the relatively big size of the black market economy. The majority of the forecasts that could be identified are based on intuitive assumptions rather than on quantitative estimations. One of the most credible forecasts seems to be the one elaborated by the National Development Strategy project "Moldova 21" accomplished by the UNDP (United Nations Development Program). In accordance with those estimations, Moldova will reach its 1990 GDP in 2015, and by 2020 the real GDP will increase four folds compared to the 2000 level at about 7,2% annual GDP growth.

For that it is necessary to have exports' growth faster than imports, although the negative trade balance nevertheless will remain. The scenario establishes that in 2010 the exports will reach $ 1,062 billion, while the imports will constitute $1,267 billion. The price index will surpass the volume growth index, for imports, as much as for the exports. Those levels seems to be plausible, although the negative trade balance from the last years seems not to fit into the scenario. Another condition for the fast economic growth is the high rate of savings and investment, and the faster than the consumption, growth of

the investment share in the GDP. In 2010 the investment is expected to account for 28,7% of the GDP, while the total consumption - 80,1%. The fulfillment of that condition seems to be more difficult than the exports growth, but the consumption so far shows growth tendencies faster than the investment and that could undermine the possibility for sustainable economic growth. The GDP structure will considerably change in until 2010 and the actual macroeconomic tendencies seem to confirm the assumption that the agriculture share will diminish from 28% in 2000 to 19% in 2010, while the absolute value of the agricultural sector will increase four folds. The industry will decrease down to 22,7% of the GDP while the service sector will increase up to 52,5%..

An important question is how will evolve the gap between the per capita GDP in Moldova compared to the European average in the short run. To model an evolution of that gap we did not used the UNDP forecast, but un alternative set of data. Table 1 shows the average of the growth rate for the EU countries, countries that joined EU on May 1st 2004and Moldova for the years 1999-2002, as well as the per capita GDP for 2002 which is obtained extrapolating the GDP levels for the year 2000 presented in the international human development report of UNDP. The average rate of the economic growth from the last four years is used to extrapolate the per capita income in 2020. The incomes vary significantly from country to country: Luxemburg has a per capita income of over $ 50 000, being the smallest country from EU, while Spain with about $20 000 and almost 40 million population. That is why, the European average is obtained by equilibrating the incomes with the population of the particular country from EU (until 2004), EU-25 (after 2004 and onwards), EU-27 (after 2007 and onwards)

The results of the modeling are presented in the Table 2. The results are not fully accurate, but they reflect the intention to show the gap between Moldova and EU countries. It could be noticed that at a Moldova 3% annual economic growth (the average for 1999-2003) the gap compared to EU will not change and stay the same at a ration of 1:10. At an average growth of 10% annually in 2020 the Moldovan incomes will represent 32% from the average European. To reach the European average in 2020, over the years 2003-2020 it is necessary to maintain an average 16, 3% annual GDP growth. The situation is insignificantly improving if the Moldova GDP for 2003-2020 is divided not to the 3,7 million people officially residing in Moldova (except for the Transnistria region), but to the number of those employed abroad of about 300.000-600.000. Also, the model assumes the hypothesis that the population of the EU countries will not change, although the real demographic tendencies show that the number of citizens in EU-15 will increase somehow, fact that will lower the European average of the income and decrease the gap with Moldova. On the other hand, if the gap is calculated not on the basis of the purchasing power, but on the basis of the currency exchange rates and assume their relative stickiness, and a steady exchange rate, the discrepancy becomes totally overwhelming, because in that case Moldovan incomes will not surpass the $3000 level not even until 2020 (8% of the EU average). In that situation Moldova would be not alone: at a 6% annual growth rate Romania needs 33 years, while Poland 22 years to reach the EU development levels.

The history shows that the economic growth over 10% are extremely rare, although are not unattainable. South Korea managed to maintain similar growth rates from 1963 until 1973, and in 1973-1978 grew by over 11% annually. In 1986-88 the Korean economy grew by 15% annually. With per capita GDP bellow $100 in 1962, today it is $10 000, aligning in the same raw with countries that offer humanitarian aid to underdeveloped countries, but that effort lasted for forty years. South Korea was able to reach that performance due to the significant export growth (on the average 16% annually between 1965-1996) phenomenal labor productivity improvement that grew annually 11% in the sixties and seventies and to the massive investment into education. Export structure has been modified from the traditional labor intensive industries with unskilled labor (textiles) towards capital intensive industries with skilled labor (electronics and auto industry). Unfortunately, a spectacular growth of over 16% that Moldova needs for a jump is impossible to be maintained for more than 18-20 years.

Obviously, any scenario of economic growth could be questioned by various political and economic fluctuations that influence country's development. The 1997-1998 global crisis was a circumstance that "charged" Moldova with several million dollar "globalization fee". That resulted in downsize of the exports and a two year turmoil.

Enlargement of the EU is a political process, extremely ambitious, with vital implications for the security and stability of the entire European continent. In order to be included on the enlargement agenda Moldova needs to demonstrate interest in European values which is fidelity to human rights, European policy, eagerness to follow European economic development direction, and Moldova meets all necessary requirements to become a EU member and be able to keep its membership. Moldova needs to show that it is ready to initiate systemic fundamental transformations necessary for the fulfillment of the approval criteria.

The cooperation between Moldova and EU should watch the promotion of the reform in agriculture and related industries, development of internal and entry to international markets. It should step aside from the traditional support of state owned enterprises and look for ways to create equal growth opportunities through transparent taxation.
Moldovan economy objectives are economic growth, modernization and competition growth of domestic companies locally and internationally, European integration with ultimate scope of reaching European living standards. Those objectives could only be attained through the implementation of appropriate market oriented policies.