MOLDOVA TRADE STUDY
Note 4

The Performance of Free Economic Zones in Moldova

The World Bank

Table of Contents

1. Executive Summary 3
2. International Experience and Trends 4
3. Overview of Free Economic Zones in Moldova 6
4. Benefits of Establishing Businesses in Free Economic Zones in Moldova 7
   4.1 Tax Benefits 7
   4.2. Benefits Due to Customs Procedures 8
5. The Economic Impact of Zones 9
   5.1 Static Gains 9
      5.1.1 *Industrial production* 9
      5.1.2 *Investments and exports* 11
      5.1.3 *Employment* 13
   5.2 Dynamic Gains 14
      5.2.1 *Export diversification* 14
      5.2.2 *Jobs and productivity spillovers* 16
6. Conclusions and Recommendations 17
   6.1 Recommendations for the Operation of Zones 18
      6.1.1 *Maximizing Benefits for the Whole Economy* 19
7. Policy Recommendations 22
8. Bibliography 24

List of Figures

Figure 1: Structure of Attracted Investments 10
Figure 2: Share of Industrial Sales and Attracted Investments 10
Figure 3: Tax Collection at Free Economic Zones 11
Figure 4: Investments in Moldovan Free Economic Zones 12
Figure 5: Exports Dynamics of Economic Zones and Export Indexes in USD, 2004=100 12
Figure 6: Employment in FEZs 13
Figure 7: Moldovan Export Patterns 15
Figure 8: Ratio of Average Economic Zone 17

List of Tables

Table 1. Economic Zone Exports 4
Table 2: Summary of Advantages and Debate Around Them 5
Table 3: Tax Benefits in Moldovan Economic Zones 7
Table 4: Summary of Free Economic Zone Performance 14
Table 5: Top 5 Main Goods Produced in Economic Zones 15

List of Boxes

Box 1: Development of Singapore Suzhou Industrial Park (SIP) 19

1. Executive Summary

In 1995, Moldova introduced free economic zone (FEZ) legislation with the aim of accelerating socioeconomic development by attracting domestic and foreign investment, promoting exports, and creating employment. Since then, seven **free economic zones** offering tax and customs benefits have been established. This note assesses the static and dynamic economic benefits of the program in Moldova.

The free economic zones have been successful in attracting investment from both domestic and foreign sources. Since 2002, the volume of foreign and domestic investments in the zones increased five-fold, reaching US$212 million in 2014. While not all investments in the zones have foreign origin, investments in the zones amount to 80 percent of total FDI stock in Moldova for the period 2009-2014.

The economic zones have become true export platforms, generating a five-fold increase in exported industrial production from the zones between 2004 and 2014. The majority of industrial production (75 percent) in the zones is exported rather than sold domestically. The share of exported products from the zone reached 9.2 percent of total Moldovan exports in 2014, from 4.2 percent in 2006. Exports from the economic zones are in general more dynamic and mainly concentrated on manufactured goods.

On average, employment in the economic zones had a robust growth in the last seven years and almost doubled since 2008. However, this increase in employment is driven by outcomes in only two zones: Balti and Ungheni, where the automotive and textile industries are located. In the rest of the zones, employment and production levels have declined since the 2008 crisis.

Evidence suggests that the economic zones have significantly contributed to the diversification of exports and to the changing structure of the Moldovan economy. The latest expansion of investments in the zones was driven by large international companies in the automotive and textile sectors, which have significantly transformed the structure of production, from beverages to electrical machinery and equipment and textiles. The share of industrial goods produced in the economic zones increased from 4.2 percent in 2006 to almost 10 percent in 2014. This diversification pattern in production can be observed in the structure of Moldovan exports.

The effect of the economic zones on domestic firms appears to be modest, however, and unlikely to contribute to the technological upgrading and sophistication of the Moldovan economy. Because the largest companies in Moldovan economic zones are part of global value chains and import most of their inputs, they have limited linkages to domestic firms. While domestic companies provide non-industry related services to zone residents such as transportation and food, these spillovers are unlikely to add much in terms of diversification and sophistication.

Free economic zones tend to attract industrial activities requiring intensive use of human resources for certain operations (e.g. fitting parts and sub-assemblies). These do not always contribute to strengthening sectorial links and diversification of the economy. In this sense, such zones in Moldova cannot be a valuable element of industrial and trade policy.

2. International Experience and Trends

Traditionally, special economic zones have been territories in which exporters and other investors receive tax, tariff, and regulatory incentives. Over time, the privileges and benefits of economic zones have expanded. Most of the provisions now include specialized services, including warehousing, transshipment, and informatics. These benefits make the zones attractive for businesses, contributing to their worldwide development.

Economic zones are set to attract investment, boost employment, increase exports, and help diversify the whole economy. They often serve as experimental labs for the application of new policies (China's Shenzen is the classic example). However, there are also costs associated with the zones. They create distortions in the economy and cannot substitute a wide liberalization of the economy. Other costs include big infrastructure investments and forgone tax revenues.

Free economic zones tend to attract firms that are export oriented and that participate in global value chains. The high export orientation of firms in the zones suggests that the contribution of these zones is considerable (**Table 1**). International companies have huge export potential, usually bigger than the non-traditional export potential of domestic companies.

Table 1. Economic Zone Exports

Region/country	**Share in Exports**
Global	40.8
Central and East Europe and Central Asia	38.7
Americas	39
Nicaragua	79.4
Dominican Republic	77
Panama	67
Asia and the Pacific	41
Bangladesh	75.6
Sri Lanka	67.1
Philippines	78.2
Pakistan	50.3
Middle East and North Africa	36.4
Lebanon	36.3
Bahrain	68.9
Morocco	61
Sub-Saharan Africa	48.7
Ghana	22.4
Madagascar	80
Mauritius	34.4

Source: BearingPoint; ILO database; WECONOMIC ZONESA (2007); FIAS research.

The development of economic zones has contributed to the diversification of exports in many countries around the globe. The structure of exports has changed towards textile and apparel industries, while more recently it has come to be dominated by electronic products. However, in industries like apparel, footwear, and electronics, the import content of exports is high, at around 60-85 percent, suggesting that the value added in production processes within the zones may be limited.

To date, the performance of economic zones in achieving their development objectives has been quite diverse. Supporters of such zones would point to the "Miracle of Shenzhen," for example, a fishing village that, since becoming an economic zone 30 years ago, transformed itself into a modern and cosmopolitan city of 14 million inhabitants, with soaring GDP per capita.[1] The majority of studies agree that economic zones have helped China since the early 1980s to liberalize the whole economy and test different economic policies.[2] Zones had positive effects in the United Arab Emirates, South Korea, Malaysia, and the Philippines. Still, the majority of such zones do not have the same success. In Africa, there are many economic zones that are considered as "white elephants." In India, hundreds of them failed to succeed. The problems usually are due to excessive bureaucracy, small investments, and poor infrastructure.

A recent study looking at the cross-country experience of economic zones concludes that they increase exports for the countries they are in and for the countries that provide intermediates and components, and succeed in avoiding the negative impact of trade protection.[3] Thus, the zones have contributed to the development of global value chains. The analysis also reveals that zones can be an excuse for governments to retain protectionist barriers elsewhere in the country. The same is true for job creation. On average, economic zones employ 0.21 percent of all workers worldwide.[1] There are low-income countries in Africa and South America that have higher employment in economic zones. The same is true for small countries.

Table 2. Summary of Advantages and Debate Around Them

Topic	Critics	Proponents
Foreign exchange earnings	Zones host import-dependent activities with low value-added.	Countries can increase value added through focused and intelligent incentives.
Industrial activity	Traditionally labor intensive and low-skilled operations.	Many zones are investing in increasing the capacity of the employees.
Policy reform	Zones are considered to be a way to avoid countrywide reforms and perpetuate rent seeking opportunities.	Zones serve as a testing ground for wider reforms.
FDI	Foreign direct investments are in low-tech and low-skill activities.	Zones are an effective tool to attract FDI
Women	Low- skilled, labor-intensive jobs (especially in apparel and textile industries) employ large numbers of women who are paid lower wages.	Zones are an important source of employment for women and they receive higher wages in the economic zones than in any other domestic sectors.
Environment	Due to weak states and institutions, zones pollute the environment.	Well-run zones have better environmental controls and practices.

Source: Adapted from "Special economic zones: performance, lessons learned, and implications for zone development, FIAS," 2008.

[1] Farole and Akinci (2011).
[2] See, for example, Wang (2013).
[3] Siroen, J and A. Yucer (2014).

The evidence to date suggests that economic zones are more effective in countries with strong state capacity and less effective in countries with weak capacity. The successful economic zones are those that are closely linked to other economic agents in the country and to the global marketplace, and largely used as catalyzers for country-wide reforms, rather than exist in enclaves within countries. This is why zones should not be a substitute for overall trade and investment reform efforts. They should be used as tools for testing and applying good practices to the rest of the territory.

3. Overview of Free Economic Zones in Moldova

According to Moldovan legislation, free economic zones are special areas of Moldovan customs territory, economically separated, with strictly demarked perimeter, where local and foreign investors can operate under special preferential conditions, particularly preferential tax and customs regimes.

According to the current law, the zones were created for a period of 25-30 years to accelerate socio-economic development of certain areas and the country by:

- attracting domestic and foreign investments;
- implementing modern equipment and technology;
- developing export-oriented production;
- applying advanced experience in production and management; and
- creating jobs.

There are seven free economic zones in Moldova that are currently active.[4] Following the enactment of the initial legislation in 1995, the first economic zone to begin operation was Expo-Business-Chisinau (Nov. 3, 1995.) The last was Balti established in 2010. For each economic zone there is one law that regulates its establishment. The zones are:

- Expo-Business-Chisinau – Chisinau FEZ;
- Ungheni-Business – Ungheni FEZ;
- Tvardita FEZ;
- Otaci-Business – Otaci FEZ;
- Vulcanesti FEZ;
- Taraclia FEZ;
- Balti FEZ.

Each zone is managed independently by an administrator who is appointed by and accountable to the minister of economy and sets its own fees and charges. Zone residents need to be registered in Moldova (legal entities with local, mixed, or foreign capital) and must be selected by zone administrators. The administrator issues licenses to companies ("residents") and is responsible for the safe, secure, and legal operation of the zone. Each type of activity within the

[4] In addition there are two other locations that are deemed to be FEZs: Aeroportul Liber Internaţional Mărculeşti; and International Free Port Giurgiuleşti.

zone is subject to a separate time-limited authorization issued by the zone administration. Each zone has a customs office responsible for ensuring compliance with customs laws and procedures.

The authorization to operate in the zone does not exempt the resident from the obligation to obtain other licenses required by law. Thus, if a particular license is needed for a given activity, then the resident must obtain that license from the licensing body, and only then obtain the authorization from the zone administration.

The license to operate an economic zone can be revoked before its expiration if the activity is contrary to the objectives of the law on free economic zones 440/2001 or to the economic interests of Moldova. All state bodies regulating the activity of the free zone, including the area administration, shall exercise their functions in full measure. Until the free zone has halted operations, all state bodies regulating its activity, including the area administration, shall exercise its functions in full measure.

4. Benefits of Establishing Businesses in Free Economic Zones in Moldova

The companies that operate under economic zone regimes in Moldova face five types of benefits:

- Protection from changes in legal initiatives, or amendments to legislation. Guarantee of no changes in legislation for up to 10 years from registration as a resident.
- Special tax and customs regimes, including free movement of goods and services within the zones (see **Table 3**).
- Sheltering from frequent inspections of state control bodies. through the administrators that act as intermediaries between these bodies and the residents.
- Possibility of profit transfer outside Moldova.
- Simplified procedures for work permits for foreign workers of the zones' residents.

4.1 Tax Benefits

Tax advantages granted to zone residents are extensive compared to the rest of the country. Low income tax rates coupled with special value-added tax (VAT) rates favor economic activity within the free economic zones and create distortions in the market. However, certain fees in specific situations might be incurred by residents, including zone entrance fees, which in some cases are substantial.

Table 3. Tax Benefits in Moldovan Economic Zones

Tax benefits in economic zones	Rest of the country
• 50% exemption from tax on income derived from export of goods and services originating in the zones or sold to other zone residents.	12% CIT
• 25% exemption from tax on income derived from activities other than exporting goods and services.	12% CIT
• For an investment in the free zone of at least US$1 million, exemption for three years from income tax derived from goods and services originating in the zone and exported outside the country.	12% CIT
• For an investment in the free zone of at least US$5 million, exemption for five years from income tax derived from goods and services originating in the free economic zone and exported outside the country.	12% CIT
• VAT is not applied to the goods delivered to the free zone.	20% VAT
• Zero VAT rate for goods and services delivered: ➢ to the free zone from outside Moldova, ➢ from the free zone outside Moldova, ➢ to the free zone from the rest of the territory of Moldova, ➢ by residents of different free zones in Moldova to each other.	20% VAT
• Exemption from excise payment for goods: ➢ introduced in the free zone from outside the Republic of Moldova; ➢ from other free zones; ➢ from the rest of the territory of Moldova; ➢ originating from this zone and exported outside the territory of the Republic of Moldova.	According to the legislation (unit and ad-valorem excises)
• Exemption from payment of excise taxes for: ➢ deliveries of goods within the free zone; ➢ deliveries of goods from one free zone to another are not subject to excise duties.	According to the legislation (unit and ad-valorem excises)

Source: National legislation, Law Nr. 440XV from July 27, 2001 Fiscal Code.

General fiscal procedures and accounting rules are the same in the economic zones and outside of them. Therefore, as in the case of the rest of the economy, the ambiguity of fiscal legislation, not the tax levels, is the most common issue.[5] In addition to the usual reports and returns to the national bodies, residents of the zones must report to the zone administrators and minister of economy on their activities.

4.2. Benefits Due to Customs Procedures

The main advantage for residents of zones derives from the presence of the customs office. High frequency interactions between residents and customs officials resulted in a constructive and beneficial environment. Most of the residents' transactions are considered low risk by default, and as a result, 95 percent of declarations are given green-line treatment, making the clearing process of imports and exports quick and easy. Customs generally processes all documents within 45 minutes and this can be tracked online.

[5] For instance, big residents of the zones had disputes with the tax authority on the level and categories of deductions. The issue became so big that the prime minister's office had to intervene.

Small investors (predominantly domestic) are attracted to economic zones because of the tax benefits, while large exporters are attracted by the efficiency of customs operations. Although *de jure*, the procedures are the same inside and outside the zone, with the support from the prime -minister office and administrators of the economic zones, residents managed to ensure certain quality and efficiency levels for customs procedures and operations. This is why, compared with the rest of the territory, custom procedures are more streamlined and efficient, and corruption and bureaucracy are reduced relative to what firms outside the zones face.

In line with the overall stated objectives of the economic zones in Moldova, tax incentives and streamlined customs procedures are clearly supporting export promotion and attraction of investments. It is evident that fiscal incentives and customs procedures in the zones are more business friendly than they are in mainstream operations. Some of these incentives and streamlined procedures could be transferred to the rest of the economy.

In general, Moldovan zones are aligned with legislative and regulatory international practices and offer most of the incentives that other zones have, with the exception of investment premiums. As further analysis shows, more efforts should be put on improving the business environment, including infrastructure, and providing "smart incentives" that encourage skills training, technology transfer/upgrading, and local economic linkages.

5. The Economic Impact of Zones

Following the existing literature, static and dynamic economic benefits will be assessed as a measure for the economic success of the economic zone program in Moldova. Static benefits are usually exemplified by short-term gains captured through trade, investment, and employment indicators. Dynamic economic benefits are the transformation of static benefits into long-term development through, for example, productivity upgrading, technology transfers, and innovation.

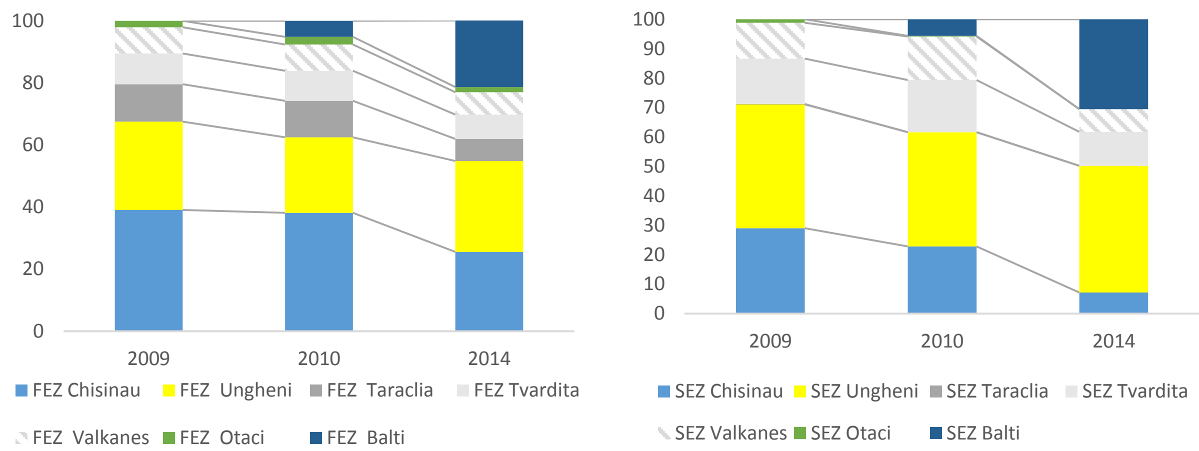
5.1 Static Gains

5.1.1 *Industrial production*

Historically, economic zones in Chisinau and Taraclia had the highest shares of industrial production and attracted investments. However, the peak of their potential may be dissipating. The economic zone in Chisinau, the first in Moldova, was opened in 1996. In 2002 it produced 70 percent of all industrial sales of the zones and attracted 46 percent of investments. The dynamism of the zone declined after 2009, probably associated with the decline in economic activity in the region. Similarly, the economic zone in Taraclia had a good start and reached relatively high levels of investment, however the absolute values show that the investment activity almost stopped in 2007. Currently, the most dynamic zones are the ones in Balti and Ungheni, the main production facilities of the automotive and textile industries. Investments in Ungheni have been steadily increasing over the past 10 years, while investments in Balti's economic zones started in 2009 and by end-2014 reached 21.5 percent of attracted investments in the zones.

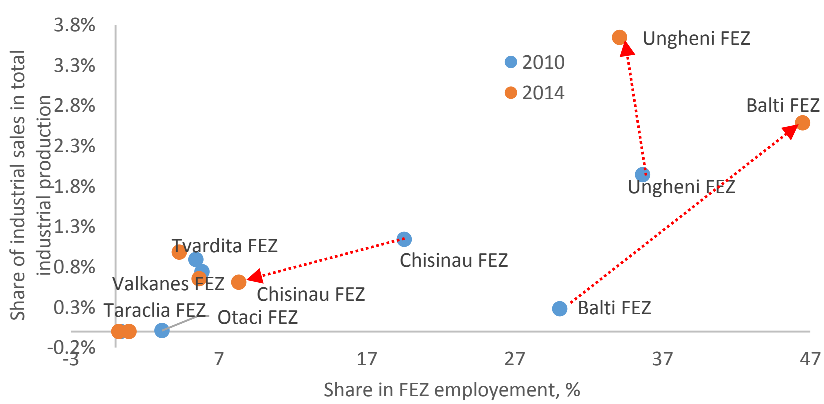
Out of the seven economic zones analyzed in Moldova, only two exhibited a continued increase in production—Balti and Ungheni. The rest of the zones, most of which existed long before the financial crisis of 2008, did not expand production by attracting more investments. Chisinau is still a big producer and exporter of industrial goods, but it seems that this is mainly because of a large alcoholic beverage producer.

Figure 1. Structure of Attracted Investments and Sales of Industrial Production (%)



Source: Elaborated by authors; based on the data from Ministry of Economy.

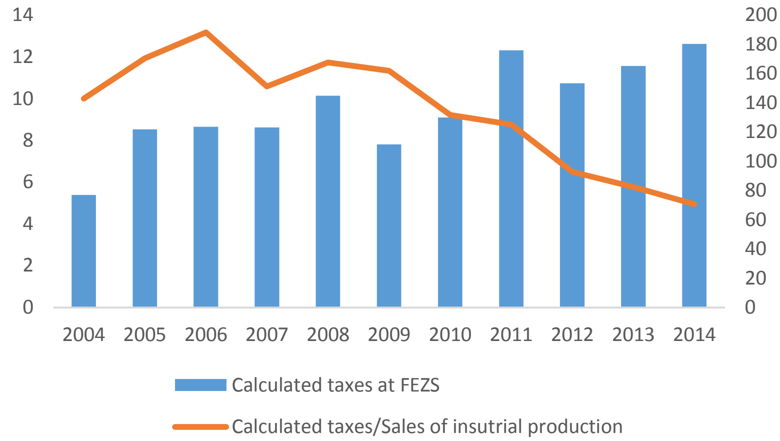
Figure 2. Share of Industrial Sales and Attracted Investments



Source: Author’s calculation based on national authorities data.

Taxes paid by the economic zones to the state is less than 1 percent of all collections and are primarily from personal income taxes of the employees. While production and exports are constantly increasing in the zones, collection of taxes has not changed.

Figure 3. Tax Collection at Free Economic Zones



Source: Elaborated by authors; based on the data from ministry of economy.

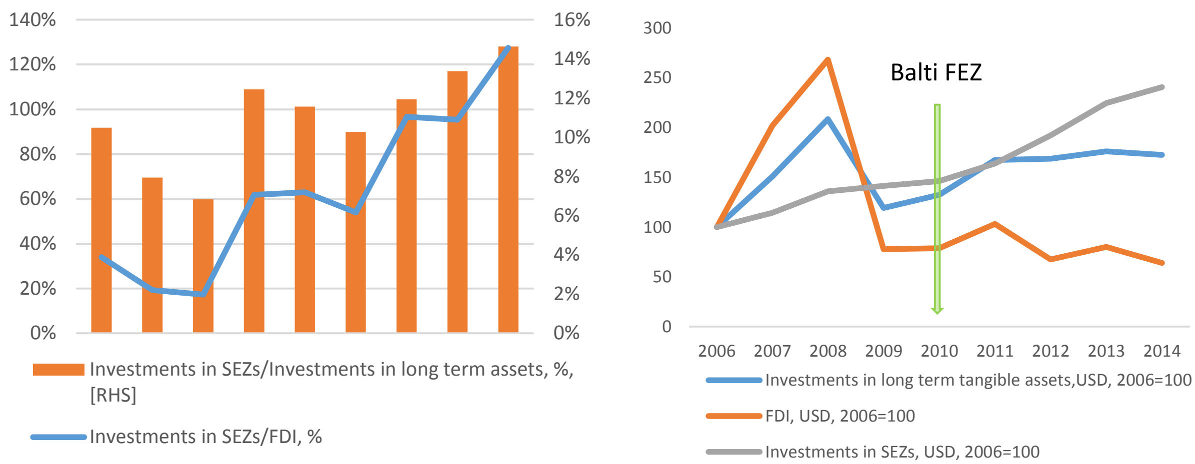
At least two of the zones are not active and at least two others are the driving force behind the growth. The role of Chisinau zone is diminishing and its sales depend on a few resident companies, of which one is a producer of alcoholic beverages and was heavily affected by the Russian ban on imports of these products from Moldova. Tax collections represent more than 20 percent of total collections in the zones, while the share of industrial production is around 7 percent. Tax collections in Tvardita are negligible and the share of sales of industrial production is at around 12 percent. Otaci and Taraclia are not performing well and the rationale behind maintaining them is not straightforward. Based on growth in employment, tax collections, and share in investments and industrial production (see **Table 3**) the spillovers and the drivers of the static and dynamic benefits could come with some reserves from economic zones in Balti, Ungheni, Chisinau, and Tavrdita.

5.1.2 *Investments and exports*

Investments in economic zones are the most dynamic in Moldova and are growing faster than FDI. One of the most important measures of the outcomes in the zones is the level of investments it attracts. Moldova does not report the level of FDI in the zones, but indirect evidence shows a compelling result. Since 2002, the volume of FDI in the zones increased five-fold, reaching US$212 million in 2014, or almost 15 percent of all long-term investments in Moldova. While not all investments in free economic zones have foreign origin, the stock of attracted investments after the crisis of 2008 reached about 80 percent of the FDI stock of Moldova or around 12 percent of all investments in long-term assets.

These levels of investments make economic zones the most concentrated areas in terms of FDI per worker, outperforming by far the rest of the country. This is an indication that benefits awarded to the residents of the zones and the overall investment-friendly environment there are more attractive for businesses as compared to the rest of the country.

Figure 4. Investments in Moldovan Free Economic Zones



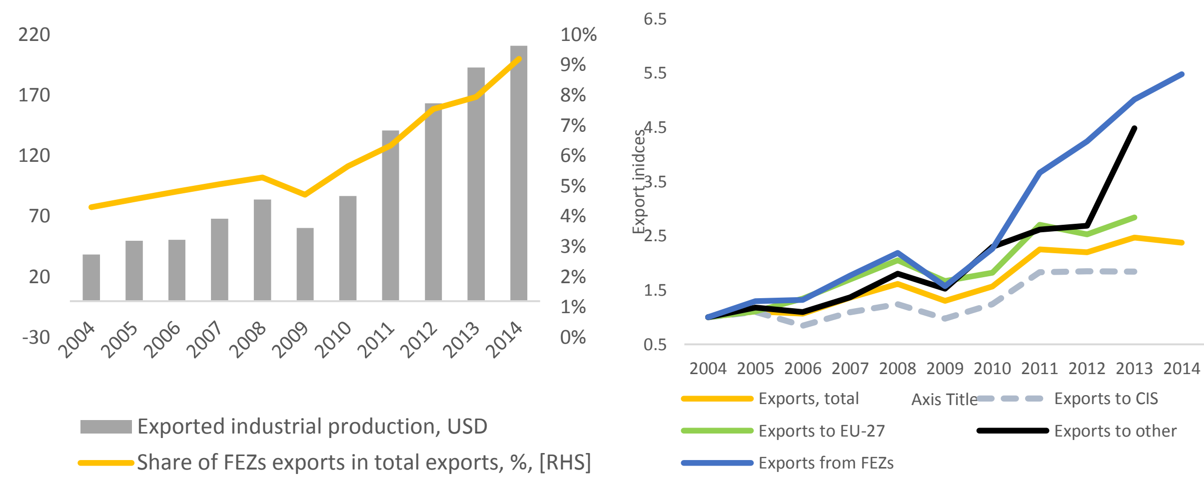
Source: Elaborated by authors; based on the data from Ministry of Economy.

The number of companies that economic zones accommodated did not change much over time—from 147 residents in 2008 to 160 in 2014. Evidence shows that large international companies in the automotive and textile sectors were behind the latest strong expansion of investments in the zones. This has contributed to export diversification (see **Note 1** on Trade Competitiveness Diagnostics) and could have implications on the possibility and scale of leveraging spillovers to the rest of the economy.

With no minimum legal export requirements, free economic zones proved to be true export platforms. Generating exports is one of the objectives behind the creation and development of the zones in Moldova. Like most economic zones around the world, Moldovan zones are highly export-intensive. The majority of industrial production in the zones is exported rather than sold domestically. The 10-year average share of exported industrial products is 75 percent of total industrial production in the zones. The remaining 15 percent is sold domestically and around 10 percent to other economic zones. The share of exported products from the zones reached 9.2 percent of total Moldovan exports in 2014, up from 4.2 percent in 2006.

Exports increased from US$50 million in 2005 to US$210 million in 2014. Two distinct periods can be observed from **Figure 2**. Before 2009, export activity was relatively stagnant. After 2010, after big automotive companies established production in Moldova, the exports from the zones increased rapidly. Exports from economic zones are in general more dynamic and are mainly concentrated on manufactured goods (see **Figure 5** for details).

Figure 5. Exports Dynamics of Economic Zones and Export Indexes in USD, 2004=100

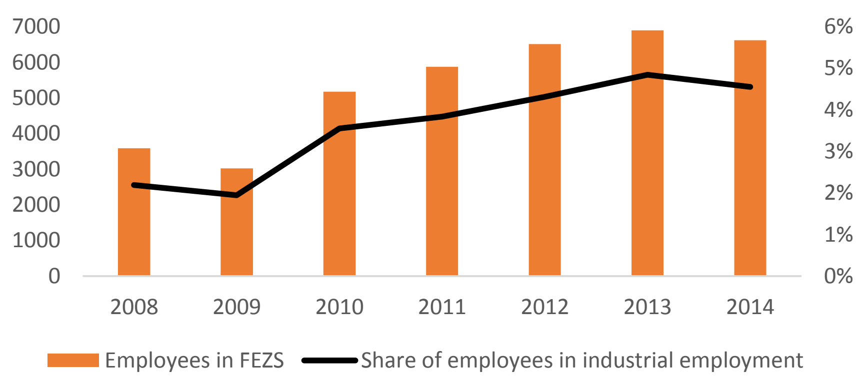


Source: Elaborated by authors based on national authority's data.

5.1.3 *Employment*

On average, employment in the economic zones had a robust growth in the last seven years and almost doubled since 2008. The evidence shows that the overall impact of most economic zones worldwide on employment is rather limited. In the case of a small agricultural country like Moldova, the contribution of economic zones to employment is not negligible, but not determinant. The available data present an increasing level of exports, while delivering relatively limited employment concentrated in specialized labor-intensive areas (automotive, textile, etc.).

Figure 6. Employment in FEZs



Source: Elaborated by authors based on national authority's data.

A robust increase in employment in the economic zones over the last few years was due to the development of two zones. In 2014, Ungheni had the highest share of employment, at 29.2 percent. The second largest employer among the economic zones is Chisinau, followed by Balti with 25.6 percent and 21.5 percent, respectively. However, the structure of employment has changed over the last four years. The majority of the zones reduced their share of total employment, except the zones with the automotive and textile industries. Without these two zones, Balti and Ungheni, employment would have decreased 28 percent in the period 2010-2014.

The decrease in employment increased the productivity per employee, as output did not decrease as much as employment. At two out of three zones that increased their shares of industrial production, Ungheni and Tvardita, employment decreased. The highest increase was registered at Ungheni, while in Balti the increase is associated with more employment. At Chisinau, the share of industrial production out of total production in Moldova decreased from 1.1 percent in 2010 to 0.6 percent in 2014.

Table 4. Summary of Free Economic Zone Performance

	Employment growth between 2014 and 2008	Share in total investments in FEZs	Share in total industrial production	Tax collections, % of FEZs collection
FEZ Chisinau	-53.3%	(-)	(-)	21 percent
FEZ Tvardita	-2.7%	(-)	(+)	7 percent
FEZ Taraclia	-92.9%	(-)	(-)	
FEZ Valkanes	39.0%	(-)	(-)	
FEZ Otaci	-68.9%	(-)	(-)	
FEZ Ungheni	63.0%	(+)	(+)	27 percent
FEZ Balti	97.8%*	(+)	(+)	45 percent

Note: * For Balti the period is 2010-2014. (+) Increase in share; (-) decrease in share.
Source: Elaborated by authors; based on the data from Ministry of Economy.

There is growing concern that employment growth may have reached its peak and will be slowing in the majority of the registered zones. In 2014, employment dropped in 6 out 7 zones by 4 percent.

There are signs that some zones in Moldova have reached their potential or are stagnate, and are susceptible to fraud, counterfeit, and smuggling. It is highly recommended to make a stocktaking assessment involving a proper cost/benefit analysis. Free economic zones may become highly reliant on single products and business entities.

5.2 Dynamic Gains

5.2.1 *Export diversification*

The long-term success of an economic zone is measured also by the extent to which it contributes to the diversification of the economy and to spillovers to the rest of the economy. Unfortunately, the evidence for the dynamic outcomes is hard to quantify with the existing data. The core idea behind establishing economic zones is to make them catalysts for growth of the whole economy. In Moldova, a diversified production implies a shift from traditional exports (agricultural products) to manufactured goods.

In 2014, Moldovan economic zones increased sales of industrial production to almost 10 percent of total production of industrial goods, from 4.2 percent in 2006. The structure of production changed significantly, shifting from beverages to electrical machinery and equipment and textiles. In 2008, the food industry accounted for the largest share of production, but in 2014, production was more diversified. The production of vehicle seat covers and electrical equipment for automotive businesses are examples of integration in regional global value chains. Worth mentioning is that production of wine and cognacs remained constant throughout the period and decreased only after the Russian ban.

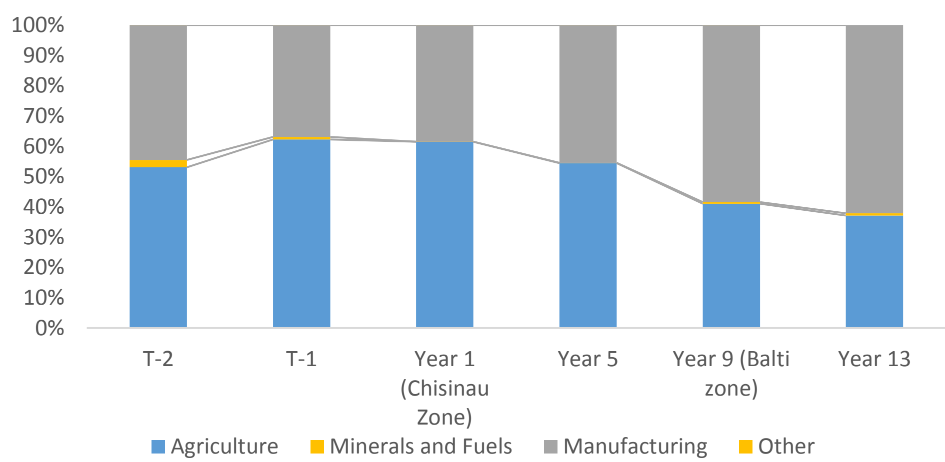
Table 5. Top 5 Main Goods Produced in Economic Zones

2008	2014
Wine	Electric cables
Cognac	Vehicle seat covers
Ceramic plates	Wire harnesses
Furniture	Wool yarn
Corks	Glass fiber

Source: Ministry of Economy.

The diversification pattern in production at economic zones can be observed in the structure of Moldovan exports. Before 1996, Moldovan exports were dominated by agricultural products, which accounted for 53 percent of exports of all goods. The structure of Moldovan exports changed, particularly after the automotive companies opened their production facilities in Balti and Ungheni. As a result, in 2014, 62 percent of Moldovan exports were manufactured goods and 37 percent agricultural goods (see **Note 1** of this report on Trade Competitiveness Diagnostics).

Figure 7. Moldovan Export Patterns



Source: Elaborated by authors.

The indirect evidence suggests some connection between structural changes in Moldovan export flows and establishment of economic zones. In contrast with other countries, the structural change in exports happened almost immediately because of a small-scale industrial sector. As previously mentioned, mainly four export-oriented foreign companies[6] and part of global production networks contributed to the diversification of Moldova's export patterns—and also to some extent to its sophistication. To consolidate these gains, it is important that more

[6] Liar Corporation, Gruber and Gruber, Drexel Maier.

companies come to Moldova to produce, and these foreign companies interact and transmit knowledge and know-how to domestic firms.

5.2.2 *Jobs and productivity spillovers*

The most important aspect of measuring success of economic zones is the effect of the spillovers that they produce. Unfortunately, here again, there is no firm-level data to allow a formal identification of spillover effects. Moldovan data does not allow a thorough analysis of the value added in the economic zones.

The spillovers are more likely to occur when foreign investors are linked to domestic companies in the production process. This can happen either in their role of competitors (horizontal spillovers), suppliers, or clients (vertical spillovers through forward or backward linkages). This is possible through the generation of incentives to innovate or upgrade, through direct training, or through the movement of skilled workforce across the economy.

The largest companies in Moldovan economic zones are part of global value chains and most of the inputs are sourced internationally with few links to domestic firms. High quality standards and control in the case of the automotive industry make it practically impossible for any sophisticated input to come from the domestic market even if such products existed. Similarly, in the textile industry, with almost negligible exceptions, all the inputs are imported. Domestic companies often provide non-industry related services to economic zone residents, such as transportation and food. In this case, there are some limited spillovers to the rest of the economy, but they are unlikely to contribute to the diversification and sophistication of the domestic economy.

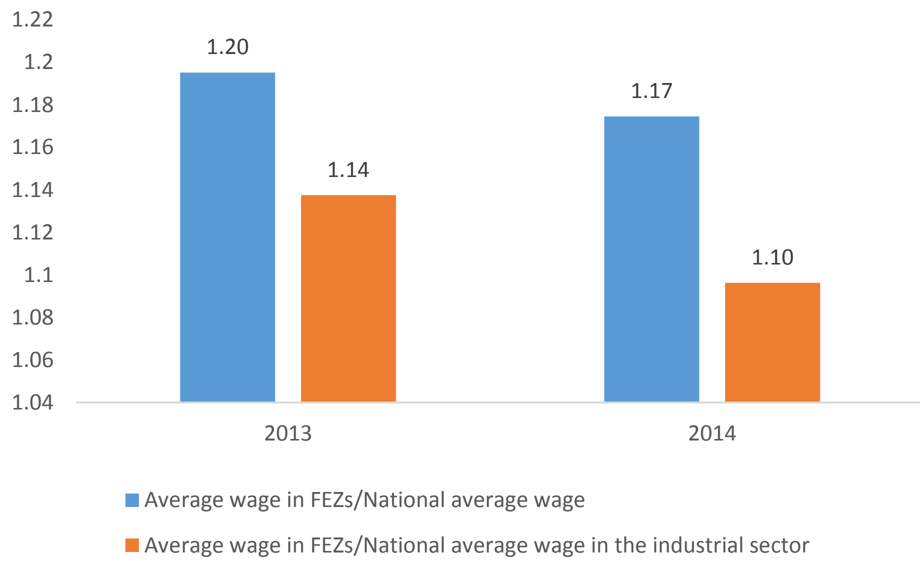
As a result of the high import content of automotive and textile industries, little value added is left in Moldova. It is highly unlikely that Moldova will start supplying inputs for the automotive industry outside the zone that are generated from domestic investments. However, Moldova could be a supplier of raw materials and other industry-related services to the textile sector. About 70 percent of added value generated domestically corresponds to wages received by local staff and up to 25 percent—fees and taxes paid by companies for land, buildings, services, etc. Probably with the exception of the food industry, the revenues from locally sourced inputs are generally very small.

The spillovers through the circulation of workers in the labor market are more likely to materialize in the case of Moldova. As workers circulate in the labor market, the training they receive in one firm becomes a skill that may be to a large extent transferrable and be of use in another firm.

Except for the food industry, the majority of employees from the zones had on-the-job training courses. In the automotive industry, these courses were more extensive, involving a more rigorous attention to increasing the skills of the labor force. With the support of residents of the zones, there is an initiative to build a specialized and modern vocational school that will prepare specialists for the industrial sector of Moldova.[7]

There is little evidence suggesting substantial spillovers through the labor market. In 2014, the share of wages paid in the zone was around 1 percent of the total wage bill in the country. The average salary in the zones is 4900 MDL or 17.5 percent higher than the average in the rest of Moldova and 9.6 percent higher than in the industrial sector. In the last two years, there is a clear trend of convergence of the nationwide average wage and average wage in the economic zones.

Figure 8. Ratio of Average Economic Zone Wages to National Wages



Source: Elaborated by authors; based on national authority’s data.

6. Conclusions and Recommendations

The economic impact of Moldovan free economic zones is ambiguous. The economic effects of a specific zone are based on its ability to attract more investment, create employment, and increase industrial production. There are clearly two distinctive periods of development of Moldovan economic zones. Before 2009, all the gains associated with the zones were driven by traditional sectors of the economy where Moldova exhibited comparative advantages, such as the food and agricultural industries. Since 2009, the development of Moldovan zones has been dependent on a handful of international companies that were part of global value chains.

[7] According to the administrator of Balti FEZ, this initiative is not yet materialized because different issues with the government.

6.1 Recommendations for the Operation of Zones

Moldovan legislation provides sound and transparent provisions, but the main issue is how this legislation is implemented. The majority of recommendations are focused on streamlining the implementation process, making it easier for companies to operate. Here are the main recommendations for improving the zones:

1. **The importance of fiscal incentives should be downgraded by shifting to targeted services for businesses.** The Moldovan experience suggests that incentives do not compensate for a poor investment climate. Worldwide, successful economic zones are moving from granting fiscal incentives to delivering quality services to investors and constantly promoting a competitive business environment. The shift to more focused incentives in targeted sectors and to emphasizing services must be accompanied by a well-functioning monitoring system.

2. **Reduce corruption and increase accountability by establishing one-stop-shop procedures and elements.** Streamlined and well-defined rules for investment approvals, work permits, import and export licenses, coupled with accelerated customs procedures are the ingredients for a successful development of economic zones. A lot is already implemented in Moldova, however authorities often do not react quickly to investment opportunities and specific demands coming from the companies. The solution is to establish one-stop-shop services with publicly accessible and monitoring elements. Additional authorization rights could be delegated to the regulator rather than having investors deal with individual line agencies. The one-stop shop should provide all approvals and licenses and assist private developers in establishing the zone and also help private investors in establishing their investments in the zone. Establishing a publicly accessible register or system with the possibility of monitoring applications will bring more accountability and accelerate the decision-making process within various government agencies and bodies.

3. **Establish a proper mechanism for monitoring and reporting with the zones residents and administrator.** All incentives given to residents should be monitored and periodically evaluated to ensure that the established objectives are met. The regulator, Ministry of Economy, does monitor all free economic zones. However, a proper evaluation mechanism should have all the necessary information for assessing the static, dynamic, and social impact of the Moldovan zones. This mechanism would help avoid encouraging tax planning rather than investments in productive capacities and help designing new incentives.

4. **Empower the regulator with additional relevant institutional capacities and capabilities.** The regulatory authority should have strong institutional capacities and capabilities to incorporate and coordinate across many stakeholders involved in a wide range of activities across various domains, including customs, land use and connectivity to utilities, taxation, business registration and licensing, immigration, and environmental, labor, and social compliance. To increase efficiency and accountability, the regulator should be an independent agency under a board of directors that is composed of representatives of all key government ministries, including regulatory agencies and private sector representatives. An empowered board is the solution for the lack of capacities of local and public tiers when dealing with connection to electricity, water, and other utilities.

5. **The role of residents in appointing the administrator should be determinant.** Clear delimitations of the role and more ownership to the private sector should facilitate the development of economic zones in Moldova. The Ministry of Economy appoints the administrator of the zones in Moldova, which may not be a bad solution. However, in most successful zones, particularly in Balti, the administrator was appointed at the request of the residents, as a condition for investment. The guiding conclusion for Moldova is that the authority, quality, capacity, and focus of the zone administrator are the keys to successful development of the zones.

6. **Establish a proper mechanism for compensating residents of the zones for restrictive treatment of the real assets.** In the majority of studies, restrictive treatment of the real assets is a major constraint in development in general and in economic zones in particular. In Moldova, foreigners cannot own land, which could impede from getting a credit. It is a an ongoing debate whether foreigners should be allowed to own land in Moldova with obvious extended consequences to the development of the zones. It is a bigger issue for domestic investments, lack of tangible assets for collateral impede access to finance and constrain domestic companies operating in the zones.

Box 1. Development of Singapore Suzhou Industrial Park (SIP)

The China Singapore Suzhou Industrial Park (SIP), a joint venture between the governments of Singapore and China, is one of China's most successful industrial parks. Despite its generally advantageous location in China, the park is landlocked. The most important areas for government support in the development of the park have been transport, logistics, and trade facilitation. The continued streamlining of customs procedures and port handling were the most important contributions of government to the success of the zone. SIP operates as a virtual port and is allowed to handle customs clearance of exports and imports directly. SIP firms enjoy an efficient "green lane" and independent customs supervision, which has run 24 hours a day, seven days a week since 2003. An integrated free trade zone (IFTZ) was established in SIP in 2008 by integrating two processing trade zones, one bonded logistic center, and one customs checkpoint.

Source: Farole, Thomas; Akinci, Gokhan. 2011. Special economic zones: progress, emerging challenges, and future directions.

6.1.1 *Maximizing Benefits for the Whole Economy*

Better linkages with the local economy are extremely important. The impact of zone development is suppressed when zones are operated as enclaves. They are multiplied when they are accompanied by countrywide economic policy and structural reforms that enhance the competitiveness of domestic enterprises and facilitate the development of backward and forward linkages. In Moldova, zones seem to operate separately from the rest of the economy. The main recommendations are:

1. **Integrate and replicate best practices observed in the zone with the broader strategic exercise.** The development of Moldovan zones should be part of a broader industrial and export promotion strategy. Zone development should become a well-coordinated initiative strongly linked to sector development strategies, ensuring in this way a clear vision of integration with the rest of the economy. The investment attraction efforts should be coordinated among the

regulators, zone administrators and Moldovan Investment and Export Promotion Organization, involving relevant control state agencies.

2. **Develop technical and support services to encourage clustering and networking among residents of the zone and the rest of the economy.** To encourage business networks and clusters between the zones and the rest of the territory, a full range of technical and support services should be developed. To fully benefit from the zone programs, governments and zone management need to consider the local comparative advantages in identifying the priority sectors and helping domestic companies to link with investors in the zones through supply chains or subcontracting. This could be achieved by encouraging foreign investors to establish joint ventures with local counterparts and by identifying regional clusters and trying to invest in those areas. Examples of such services are quality and productivity centers, business incubators, technical extension services, specialized companies for quality standards and testing, and research and development laboratories linked to universities. To strengthen and increase the linkages with the national economy, the incentives mechanism must encourage the development of domestic suppliers programs and training of workers. Moreover, Moldovan zone development strategies should include clear collaborative mechanisms among investment projects in the zones and firms and research institutions in the local economy.

3. **Some practices used in the zones could be adapted for the rest of the economy, which would improve the business and investment climate.** The main advantages of zone residents that boosted investments and exports over the rest of the domestic companies are related to better accountability of government agencies because of the administrator and his role, more and better fiscal and customs incentives and better infrastructure.

4. **Extend the use of one-stop-shop procedures and improve the use of risk-based management.** While better infrastructure is harder to realize in the short term and needs considerable resources, the main policy recommendations will focus on the rest of the drivers of development in the zones. Better accountability of the government could be achieved through the implementation and wide use of proper one-stop-shop systems with modern information infrastructure that would reduce interaction with the government. More effective use of risk-management information technologies and compliance management would create the possibility of applying this advantage to the entire domestic economy.

5. **Shift to a common set of incentives for all promoted areas of the economy and not just for the zones, making fiscal and customs incentives less heterogeneous.** This would eliminate unfair competition and promote a balanced growth. For instance, big exporters from economic zones in Moldova benefit from the privileges of the Authorized Economic Operator (AEO). Under AEO authorization, a business entity can operate faster by having more and faster streamlined procedures and has less state controls.

6. **Extend the privileges and the concept of the AEO to other regulatory agencies and streamline the procedures for obtaining it.** Operators can be accredited by customs as AEOs when they satisfy certain high standards of internal processes and past performance that will assure customs that they are compliant with relevant requirements and therefore can be treated as low risk. The advantage for the trader is less intervention by customs and better

predictability of supply. A similar concept is applied by the tax authority. Increasing and extending the number of AEOs should lead to improved investment and business environment in the whole economy. Applying the same principals and extending the concept to other state control bodies, fully benefiting from risk-based management systems, will reduce significantly the cost of doing business.

7. Policy Recommendations

What could be done to increase the economic and investment activity in the zones? How can the Moldovan economy benefit from the best practices in the zones and increase spillovers to the rest of the economy?

	Shorter to medium-term	*Medium to longer-term*
1. Recommendations for development and increasing investments in the zones		
1.1. Downgrade fiscal incentives and shift to targeted services	• Undertake a cost-benefit analysis of the incentives given to the residents of the zones.	• Design and implement mechanisms of delivering various quality services to the zones, moving away from fiscal incentives. • Establish a proper assessment and monitoring mechanism of incentives granted to the zones, including assessment of static, dynamic, and social impact.
1.2. Consolidate and promote efforts to reduce corruption and increase accountability	• Streamline and define clear rules for investment approvals, work permits, and import and export licenses for the residents of the zones. • Institute the regulator as an independent agency under a board of directors composed of representatives of all key involved government ministries, control and regulatory agencies, and private sector representatives. • Increase the role of residents of the zones to appoint the administrator.	• Establish and extend the one-stop-shop mechanisms and procedures in the zones, dealing with approvals and licenses. The scope is to help private developers get established in the zones and also assist private investors in establishing their investments in the zone.
1.3. Actively promote investments in the zones		• Establish a proper mechanism for compensating residents of the zones for restrictive treatment of the real assets (i.e. land) that impede access to finance. • Include marketing and promotion activities in relevant strategies.
2. Recommendations for increasing the spillovers and good practices to the whole economy		
2.1. Increase linkages and positive spillovers between the zones and the rest of the economy	• Include the development and experience of the zones in broader industrial and export promotion strategies and strategic documents. • Strengthen cooperation between the regulator, MIEPO, zone residents, and administrators of the zones.	• Develop clear collaborative mechanisms among investment projects in the zones, domestic companies, and research institutions in the local economy by introducing various trainings and internship programs. • Develop and implement a clustering and networking system of collaboration between zone residents and domestic companies by introducing development programs for

		suppliers.
2.2. Adopt best practices from the zones	• Extend the use of the risk-based and compliance management systems for all relevant state agencies to reduce bureaucracy and corruption. • Implementation and wide use of proper one-stop-shops systems with modern information infrastructure that would reduce interaction with the government. • Extend to the rest of the economy the privileges and concept of Authorized Economic Operator to other regulatory agencies and streamline the procedures for obtaining it.	• Continue the efforts of extending customs and fiscal "modus operandi" used in the zones to the rest of the economy. In particular, implementation of all custom's special treatment and procedures and standards to the rest of the economy. Elaboration of control and procedures manuals at customs and tax office.

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