# THROUGH FINANCIAL STABILITY TO SUSTAINABLE ECONOMIC GROWTH

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*"Whoever controls the volume of money in any country is absolute master of all industry and commerce."*

(James A. Garfield, the 20th USA President)

***Abstract***: *The present article analyses some transformations suffered by the financial systems in the framework of new economic environment realities, including the financial and economic crisis, and also a number of indicators such as dynamics of banks' loans balances, the interest rate on loans and deposits, the balance of deposits in the banking sector, money transfers from abroad, official reserve assets, foreign debt, etc. We can conclude that Moldovan economy has favorable conditions to ensure financial stability capable of generating economic growth.*

***Keywords**:* Financial Policies, Public Economics, Fiscal Policies, Economic Develepment, Economic Growth

***JEL Classification**:* G1, H0, H3, O1, O2, O3

The new realities of the national, regional or global economic environment, which are becoming more and more globalized, with a constantly growing competition, with new opportunities, but also with new uncertainties, as well as profound transformations borne by financial systems under the influence innovation technology, globalization and liberalization of capital flows, trends specific to the last few decades, have

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made capital flow in sophisticated ways and on markets increasingly integrated worldwide. And even though in the long run, this development promotes more efficient allocation of capital resources, finance is not exempt from destabilizing voltage generating risks for both, players in the financial industry and the economies as a whole. The proof is the Euro zone debt crisis, which continues to be a factor of instability. Along with harsh fiscal policies, there is a decrease in the share of funds gathered in the capital of European banks, which could lead to reduced lending of the real economy, and why not, of the capital export to countries with developing economies. Another problem is unemployment. During the economic crisis in 2008-2009 was registered a considerable increase in productivity, particularly in the sectors of production, including as a result of massive layoffs, and the services sector was not able to absorb laid off labor force. However, so far there is no reason to declare that European countries are entering a new crisis, even though some of them are facing problems related to economic growth. The main paradox is the fact that markets need budgetary stability, but, as a consequence, reacts negatively to economic growth.

Eventually, the measures taken by the European countries, including monetary policy instruments, along with optimism generated by some positive developments in the US economy, could positively affect the global growth. However, we must admit that in a globalized financial environment and increasingly sophisticated, financial stability represents a new challenge for modern economies and a prerequisite for ensuring sustainable growth. Financial stability should be a priority also for the central banks which stand on the top of the national financial systems, thus requiring a close cooperation and collaboration with various institutions and organizations nationally and internationally.

It should be mentioned that the economic literature and practice has not yet reached a common view on the content of the concept of “financial stability”, on the contrary, it is more about “financial instability”. In this context, “financial stability” can be defined as a state of the financial system without systemic disturbances that affect the economic performance in general, i.e. without financial instability, characterized by the formation of financial bubbles, able to explode anytime, excessive volatility of stock prices, abnormal reduction of liquidity in certain market segments, failure of the payment systems, excessive credit limitation, bankruptcy of financial institutions etc. This requires a thorough analysis of all elements that constitute the financial system in terms of their effects on financial stability.

It should be also noted that the historical, economic and social context of the country has influenced over the years the content and the functioning of the baking system and market. Of course we cannot state, or talk about old traditions when referring to Moldova's banking system. The country's independence and transition (unfortunately too long) to market economy required fundamental changes in economic theory and practice, including reorganization, reformation, and why not, the establishment of the financial-banking system, based on the ex-soviet system. There arose the need to train specialist in the banking field and the Academy of Economic Studies of Moldova is the leading institution. During this period of time, the banking activity has suffered profound changes due to some economic phenomena, such as increased competition between banks, diversification of activities and services, emergence of new banking services based on advanced processing technologies and information transfer, adding other categories of operations to the bank activities, even if through daughter companies, such as leasing operations, insurance and reinsurance (here we mention that the national legislation could be adapted to the European practice), also, the banking institutions have proved that they acquired efficient skills in financial risk management.

We believe that today the Moldovan banks represent a genuine **banking system**, have an active role in the economy, with an increased profitability, continuous downward trend (during the last 3 years) in the average interest rate on loans, thus, offering support to businesses, supporting investment activity, demonstrating stability, safety, and thus, contributing to the economic growth, preferably durable, able to generate employment, competitiveness and social cohesion.

Moldova's commercial banks represented the first line of defense against the economic and financial crisis that we faced and have shown resilience and have suffered less than the real economy.

Today, the National Bank's monetary policy is more intelligent and effective in both, macroeconomic stability and improvement of the real lending sector of economy. We believe that the National Bank of Moldova, during the crisis and later on, has used effectively the monetary policy instruments, in order to maintain the exchange rate of the national currency and to ensure control over inflation, using for this purpose and required reserves as a tool to control money supply. At the same time we must admit that these drastic measures may have some negative consequences on economic growth, or, halting inflation means some sacrifices to production activities, investment activities.

The above mentioned allow us to consider that the *Moldovan economy has favorable conditions to ensure financial stability capable of generating economic growth*.

Thus, for the last years we can state a general continuous upward trend of credits granted by the banking sector, which at the end of April 2013 amounted MDL 36.5 billion (figure 1), a different trend compared to the one registered during the crisis in 2008-2009.

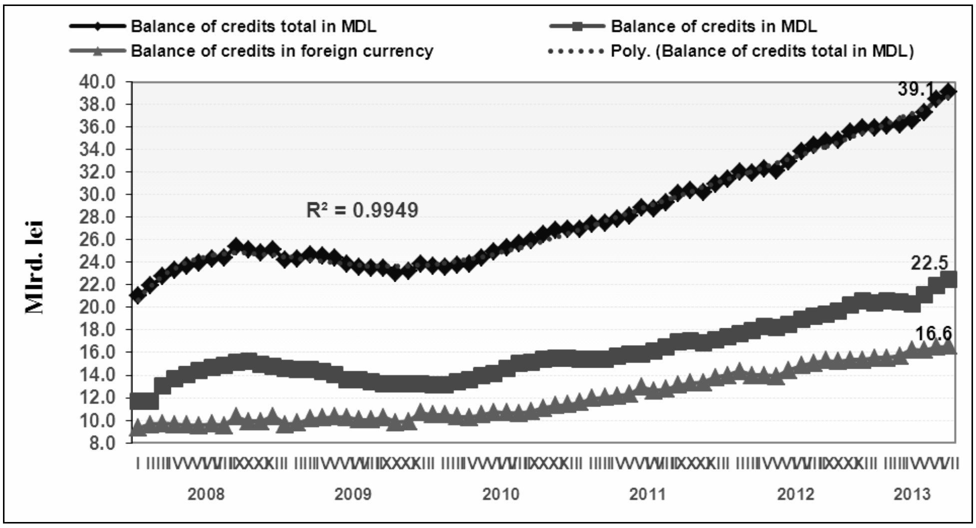


*Figure 1. Dynamics of the balance of credits offered by the banking sector at the end of the period 2008-2013 (billion MDL)*

This is due to the general decreasing trend of interest rates set by commercial banks for loans given both in MDL and foreign currency, as well as reducing the bank margin both in national and foreign currency operations (figures 2, 3).

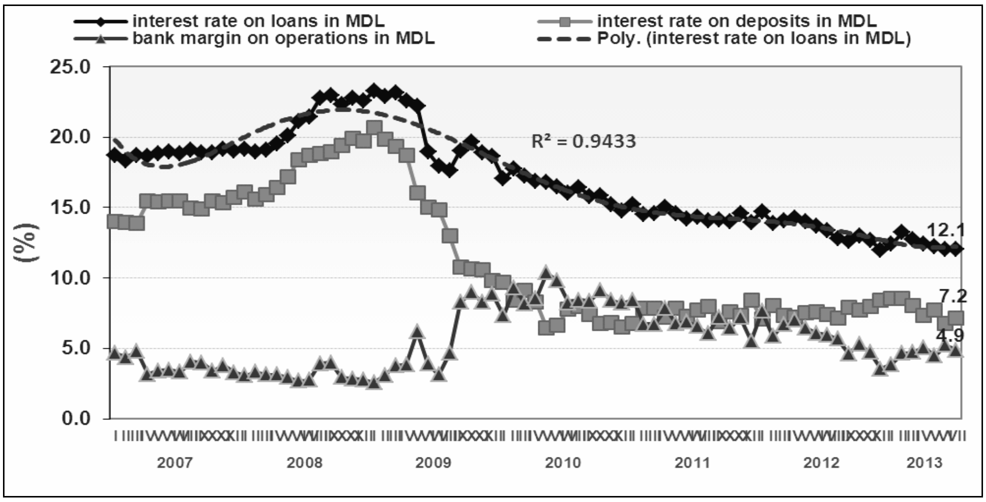


*Figure 2. Dynamics of interest rates on loans and deposits, lending bank margin in MDL during 2008-2013*

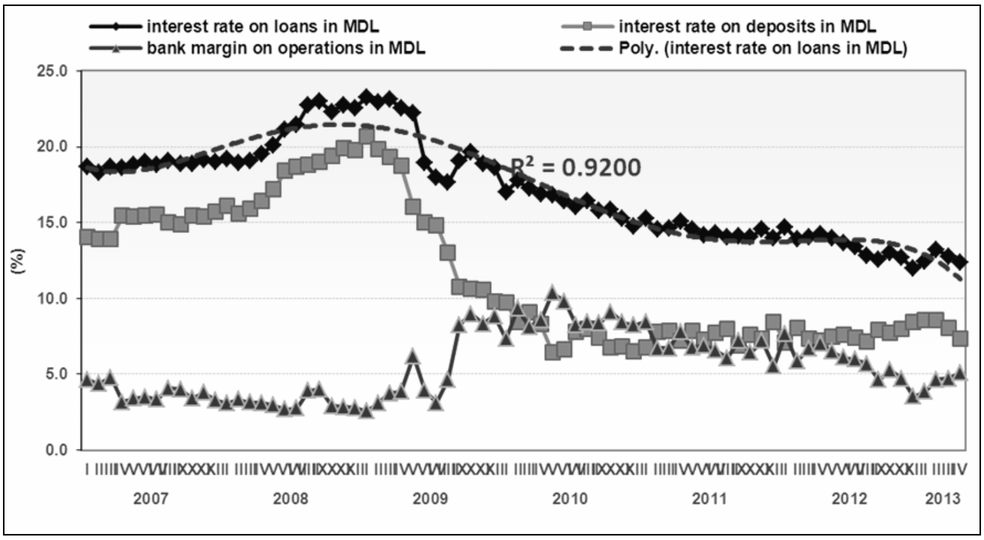


*Figure 3. Dynamics of interest rate on loans and deposits, lending bank margin in foreign currency during 2008-2013*

With few exceptions, the increase of banking deposits, as a source of increased liquidity of banks can be regarded as positive, which at the end of April was MDL 37.1 billion, of which 22.5 billion in MDL and 14.6 billion in foreign currency (figure 4).

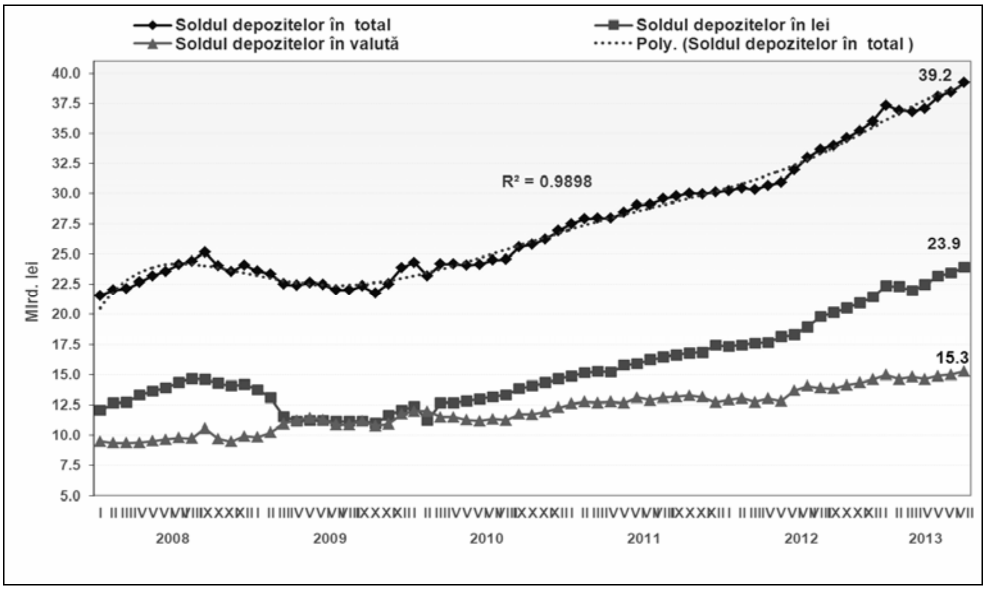


*Figure 4. Dynamics of deposits balance in the banking sector during 2008-2013 (billion MDL)*

Even though the remittances from the people working abroad have not reached the level of 2008, for the past four years there is an upward trend. In March of the current year they reached USD 118 million (figure 5) and during USD 2012 – 1494.2 million (figure 6). Even if the share of foreign remittances in the GDP has a decreasing tendency (20.6% in 2012 compared to 27.4 in 2009), they remain a major source of stimulating domestic demand and supplying the liquidity of the banking system.

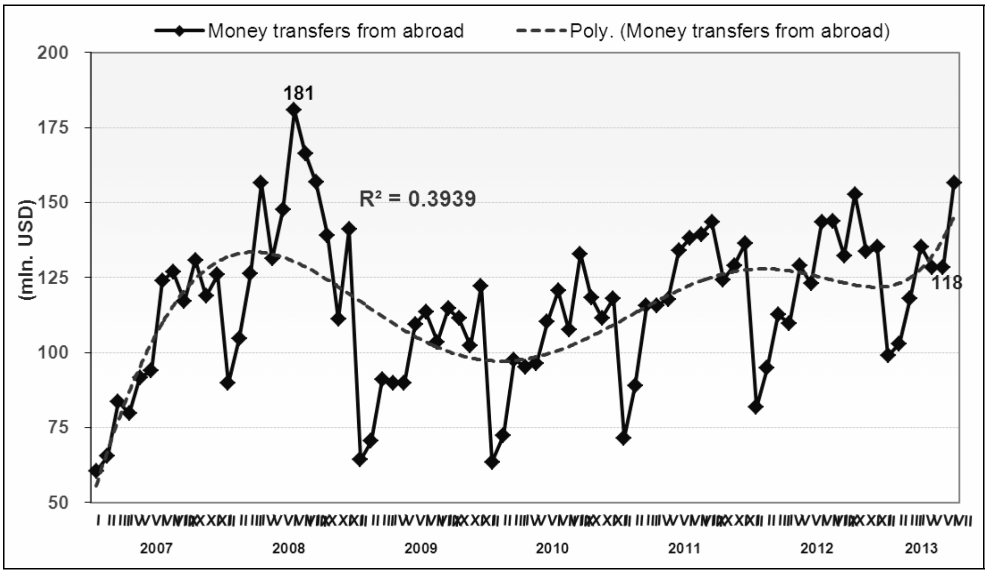


*Figure 5. Dynamics of money transfers from individuals living abroad (residents and nonresidents) through Moldova's banks during 2008-2013*

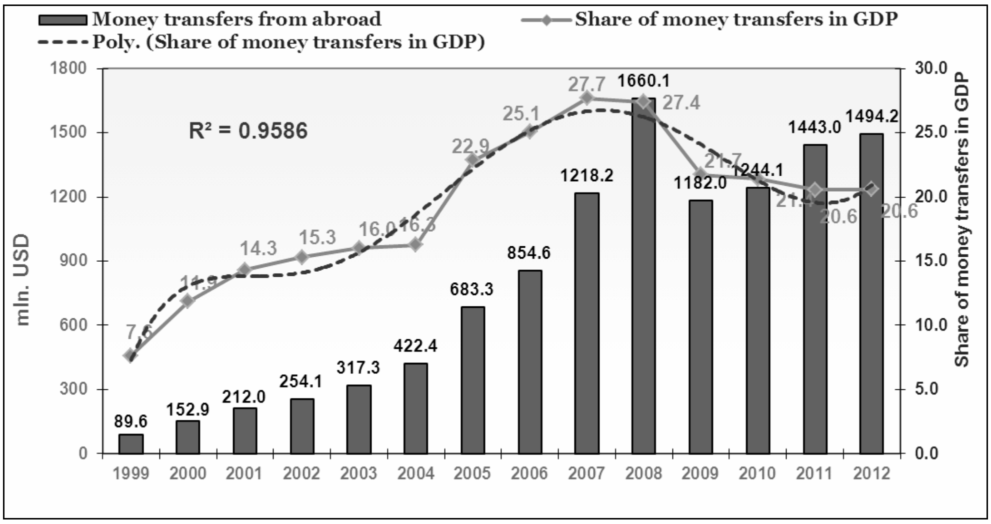


*Figure 6. Share of money transfers from individuals living abroad in GDP through Moldovan banks during 1999-2013*

It is also noteworthy that the National Bank of Moldova has not been lately involved in the sale of currency, similar to actions in 2009 (figure 7), on the contrary, has contributed to the increase of the state foreign exchange reserves, which reached USD 2481.0 million at the end of April of the current year (figure 8), coverage of imports by reserve assets constituting 5.1 (figure 9).

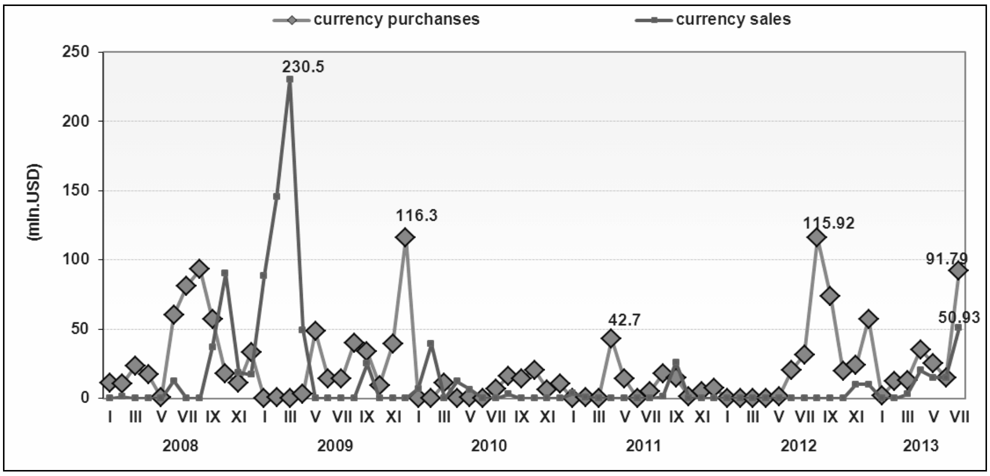


*Figure 7. Activity of the National Bank of Moldova on the exchange market during 2008-2012*

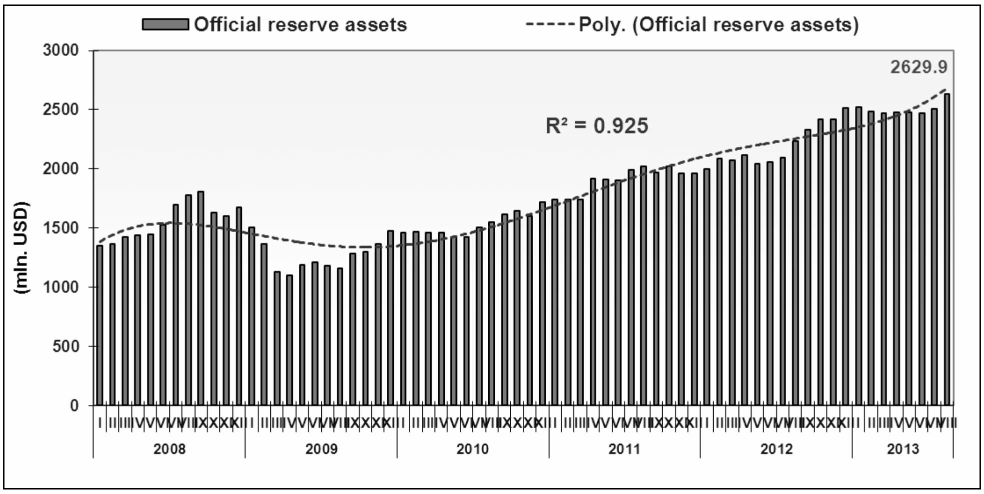


*Figure 8. Dynamics of official reserve assets of the Republic of Moldova during 2008-2013 (4 months)*

At first sight, a problem for the Moldovan economy is the continuous growth of foreign debt.

However, even though the total external debt of the Republic of Moldova, during the last 10 years have an increasing tendency, reaching the amount of USD 6132 million by the end of 2012, we should point out that the greatest share belongs to the private sector, while the public debt increases at much smaller rates (figure 10).

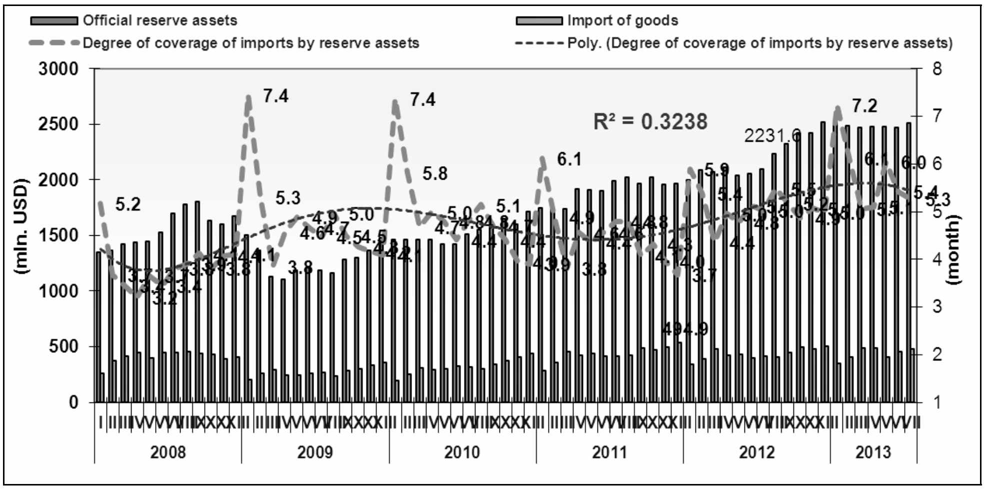


*Figure 9. Dynamics of official reserve assets of the Republic of Moldova and coverage of imports during 2008-2013 (6 months)*

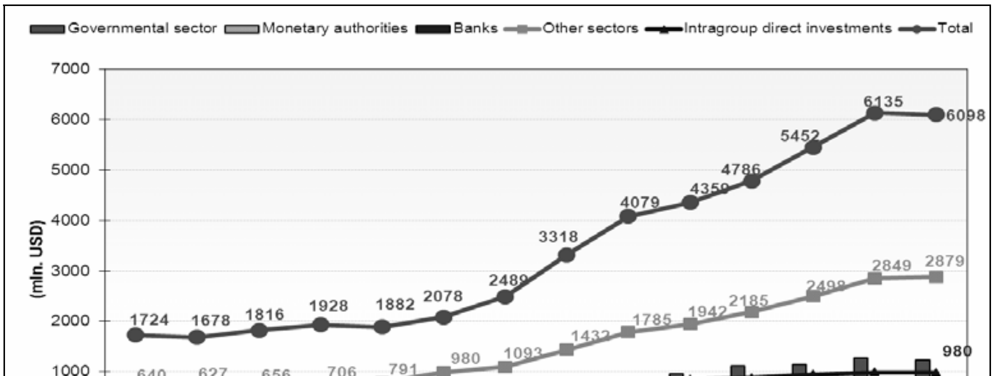


*Figure 10. Moldova's external debt dynamics during 2000-2012 (stock at end of the period*

The situation is a little different when we talk about public external debt to GDP, which constituted 63.3% in 2000 and only 17.2% at the end of 2012 (figure 11).


*Figure 11. Dynamics of Moldova's external debt and public debt to GDP during 2000-2012*

Noteworthy is the fact that according to the external debt to GDP ratio and the public external debt, Moldova's situation is much lower than of most European developed countries and almost similar to neighboring states (Ukraine, Romania, Bulgaria) (figures 12, 13) and, thus, we can consider that currently this does not affect the country's economic security.

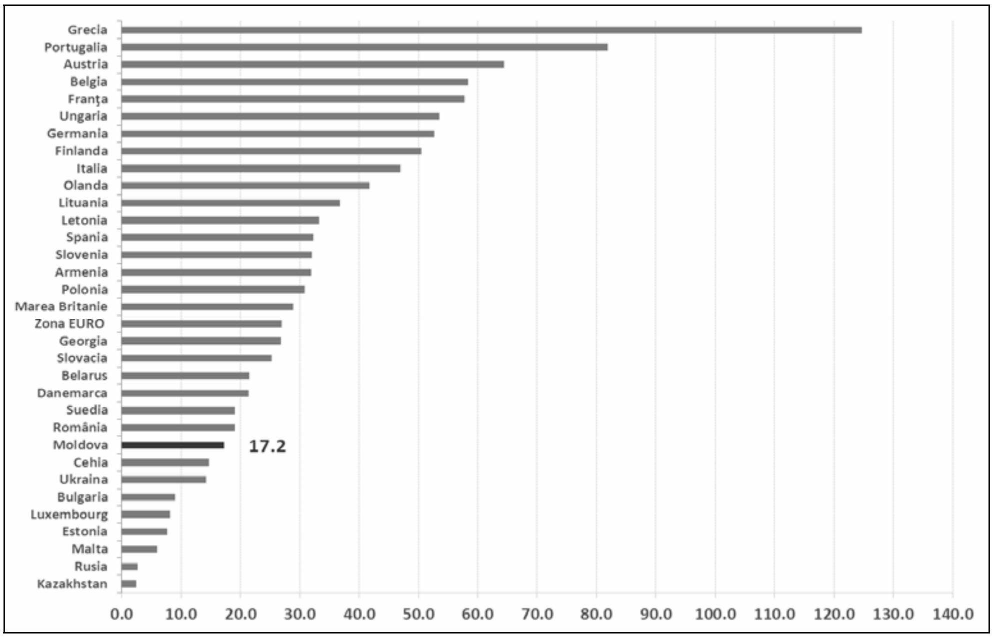


*Figure 12. Dynamics of external public debt ratio to GDP during 2012 in some countries, (%)*

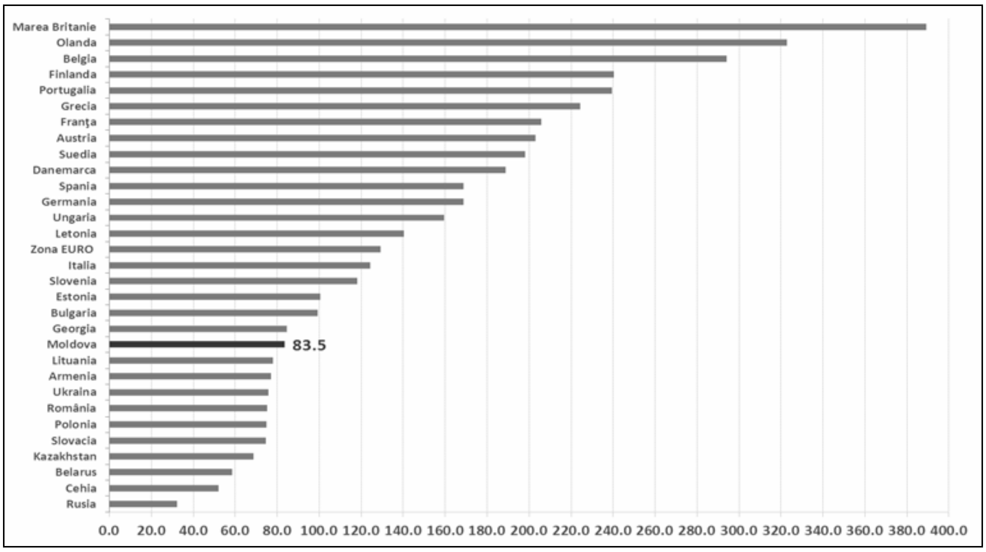


*Figure 13. Dynamics of the total external debt to GDP ratio during 2012 in some countries, (%)*

Similarly, the coverage of external debt through state's exchange reserves is also growing, constituting 40.5% by the end of March 2013 (figure 14).

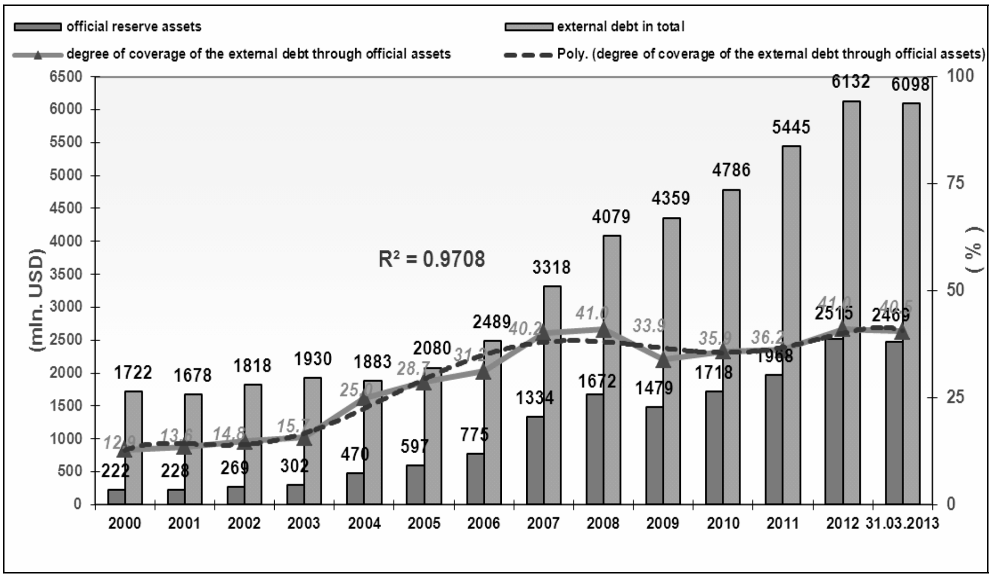


*Figure 14. Dynamics of Moldova's external debt and official reserve assets during 2000-2013*

Of course, the economic and financial crisis, faced by most world countries, has generated processes capable of changing economic and social system globally and the recovery rates of economic growth in the pre-crisis period, the economic recovery as a whole, could become, for some states, a long process full of uncertainties. Under the given situation, a special importance is given to the development of new models, recognizing that **competitiveness and efficiency will be the drivers of sustainable growth.** In this context, the issue of economic competitiveness, of acquiring and maintaining competitive advantages, using efficiently the factors causing them, and overall sustainable development of the national economy becomes a priority and an actual issue in insuring a sustainable economic growth.

It is worth mentioning that Moldova is considered today as having a **transition economy, from one based on intensive use of primary factors**, towards one based on investments (table 1). For the first type is specific the **concentration of exports to industries that exploit the advantage of low price of primary factors (natural resources, climate, labor force)**, usually with **low competition, subcontractor industries, which are weak or absent, low purchasing power, which makes the market less attractive, and techniques and technologies are largely imported,** thus, making the economy very sensitive to global economic crisis and changing exchange rates, whilst, for the second type, competition is the result of efficient production growth and improvement of products and services' quality.

**Table 5 - Distribution of world states by level of development in 2013**

| **Level 1** | **Transition from level 1 to 2** | **Level 2** | **Transition from level 2 to 3** | **Level 3** |
|---|---|---|---|---|
| Bangladesh | Algeria | Albania | Argentina | Australia |
| Benin | Azerbaijan | Bosnia Hertsegovina | Brazil | Canada |
| Burkina Faso | Armenia | Bulgaria | Croatia | Cyprus |
| Kampuchea | Bhutan | China | Estonia | Czech Republic |
| Ethiopia | Egypt | Ecuador | Russian Federation | Hong Kong |
| India | Gabon | Georgia | Kazahstan | Israel |
| Kyrgyzstan | Iran | Macedonia | Latvia | Japan |
| Nepal | **R. Moldova** | Montenegro | Lithuania | Norway |
| Nigeria | Mongolia | Romania | Poland | Slovenia |
| Pakistan | Philippine | Serbia | Turkey | EU 15 states |
| Tajikistan | Venezuela | Ukraine | Hungary | USA |
| ... | ... | ... | ... | ... |
| **38 countries** | **20 countries** | **31 countries** | **22 countries** | **37 countries** |

The Republic of Moldova continues to have serious gaps in competitiveness compared to the absolute majority of European countries, in all the determinants of competitive ability and the largest gap occurs primarily in terms on innovation and R & D, information society, being placed in the Global Competitiveness Report for 2013-2014, elaborated by the World Economic Forum, on position 138 for “Innovation” (position 135 in previous Report), and “The complexity of business” - 125 (position 121 in 2012) (figure 15).

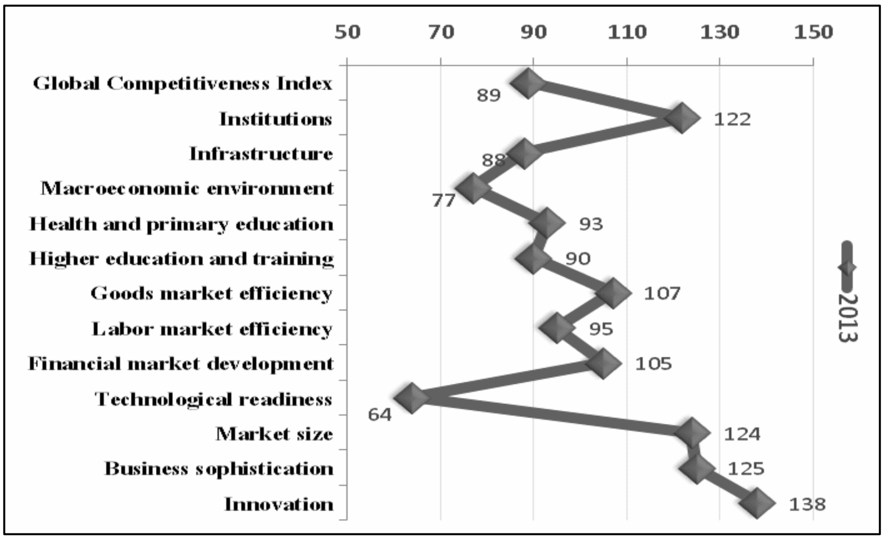


*Figure 15. Moldova’s Global Competitiveness Index in 2013*

Among the ranking factors with positive impact on the Global Competitiveness Index of the Republic of Moldova in 2013 can be considered:

- Malaria cases to 100000 population – position 1
- Business impact of malaria – position 1.
- Business costs of terrorism – position 10
- Imports as a percentage of GDP – position 20
- Internet access – position 23
- Women in labour force – position 28
- Legal rights index– position 28
- General government debt, % GDP – position 29
- Fixed telephone lines – position 32
- Flexibility of wage determination - position 34
- Pay and productivity- position 34
- Total tax rate, % of GDP – position 40

- Time to enforce a contract/days – position 43
- Business costs of crime and violence – position 54
- Government budget balance, % of GDP – position 59
- Mobile telephone subscriptions – position 59

At the same time, as factors with negative impact on Global Competiveness Ranking of the Republic of Moldova in 2013, which must be a country's priority in order to improve competiveness be considered:

- Quality of roads– position 148
- Company spending on R&D – position 148
- State of cluster development – position 147
- Country capacity to attract talent – position 146
- Judicial independence – position 145
- Company spending on R&D – position 142
- Gov't procurement of advanced tech products – position 139
- Quality of port infrastructure – position 138
- Agricultural policy costs – position 134
- Capacity for innovation – position 134
- Effectiveness of anti-monopoly policy – position 133
- Extent of market dominance – position 133
- Availability of scientists and engineers – position 131
- Quality of scientific research institutions – position 132
- Property rights – position 131
- University-industry collaboration in R&D – position 129
- Local market financing equity– position 127
- Degree of customer orientation – position 126
- Domestic market size index – position 126
- Quality of air transport infrastructure – position 116

Business success or failure within an economy can be caused by a wide range of factors that impact negatively or positively the development of the real business. However, the experience of U.S., Japan and other countries demonstrates that the competitiveness of these countries began at the level of certain companies. This can be seen in the works of famous scientists in the field (M. Porter, J. Shumpeter etc.). When talking about national economy, in fact refer to business competitiveness of companies participating directly in the competitive struggle, both on domestic and foreign market. If, in order to survive, a company only needs to continuously adapt to the environment in which it operates, then, in order to be competitive, it needs to comply with certain favoring rules. The environment, in this case, can be understood as a set of performances that are presented as the legal, political, cultural and economic environments, but also the essential changes of the system of values and social behavior in general.

Starting from the above mentioned, within the national survey conducted among 108 companies from all the regions of the country, and represent the most important sectors of the national economy, the respondents were asked to indicate from a provided list, five the most problematic factors for business development in Moldova. The research has shown that the factors with the greatest negative impact on business performance can be considered those stated in (figure 16):

- Corruption – mentioned by 84.2% of surveyed companies (in 2012 - 79.6%);
- Policy instability – factor mentioned by 75.0%% of all surveyed enterprises (in 2012 – 58.4%);
- Government instability – 50.8%
- Tax regulations – 45.8%;
- Inefficient government bureaucracy - 45.8%;

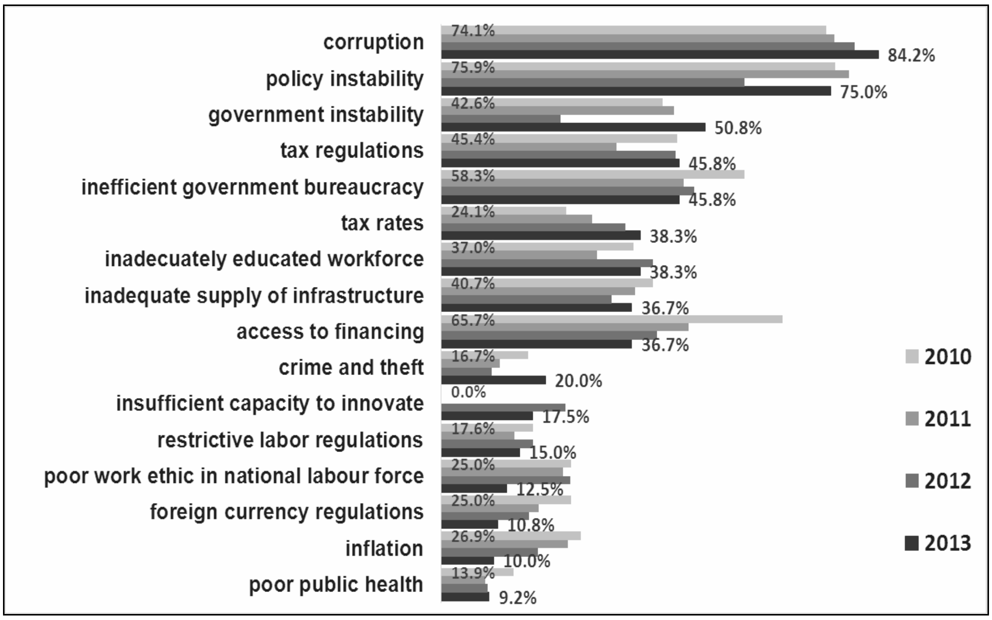


*Figure 16. Incidence of negative factors in doing business*

However, human health is not considered a great thereat for business, a factor mentioned only by 9.2% respondents, inflation (10%), restrictions on currency market (10.8%).

With reference to the degree of Financial Market development, the Republic of Moldova was placed on the Global Competiveness Report on 105 ranking (which influenced negatively the general ranking - 89), but it is better than the one of some East-European countries like Greece (ranking 138), Bosnia and Herzegovina (ranking 113) and Albania (ranking 128), or some CIS countries like Russian Federation (ranking 121), Kyrgyzstan (ranking 112), Ukraine (117).

A better appreciation of the index determine the degree of financial market development in Moldova in 2013 was given to the legal rights index on financial market – ranking 28 and ease of access to loans – ranking 104 (figure 17).

However, among the factors with negative impact on Moldova's competitiveness ranking, according to the financial market index, we can mention: financing through local equity market – ranking 124, financing through local equity market regulation of securities exchanges – ranking 119, soundness of banks – 118, venture capital availability – ranking 118, availability of financial services – ranking 118.

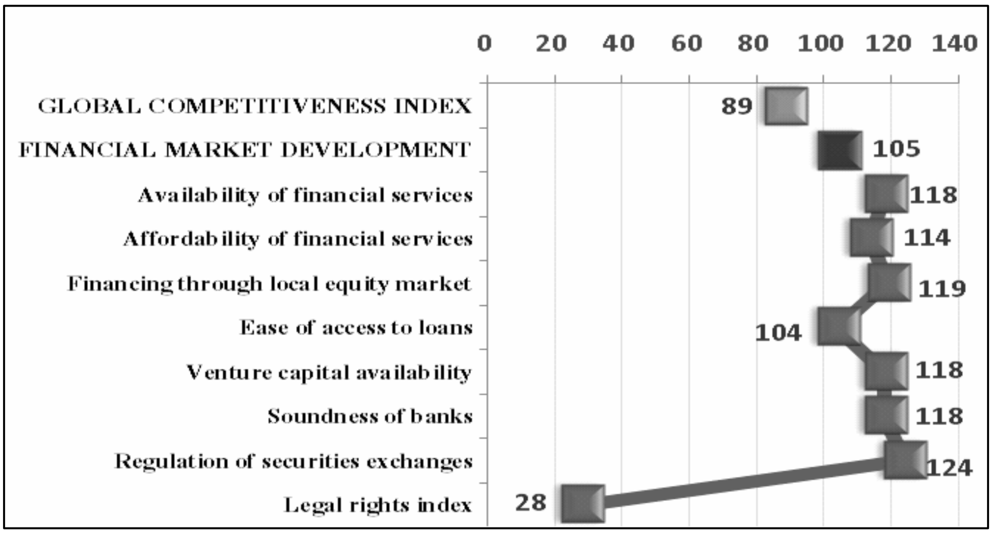


*Figure 17 Financial Market Development Index in 2013*

It is worth mentioning that the recent activities on the financial market prove that we have a stable banking system, but we must admit that it is also less integrated into international financial flows, the banking system continues to be characterized by a relatively high degree of concentration and a relatively low level of competition, there is a low density compared to the EU banking network. Despite the strong development of the banking system, the Republic of Moldova has still a huge potential for growth on this market, including the volume of loans and banking services to individuals and businesses. The banking system restructuring is an absolute necessity in the context of European integration and the desire we must admit we need competitive banks both nationally and regionally and, why not, European and worldwide.

- The main problems that Moldova's economy is currently facing are not economic and are manly related to:
  - unsolved Transnistrian conflict and lack of a clear perspective of the future of the Republic of Moldova, causing political instability and low investment attractiveness;
  - unreformed judiciary system, respectively, distrust in property protection, with similar consequences.
- Economic and financial crisis experienced by most countries determined the necessity to seek new models of development, recognizing that during the post-crisis period **competitiveness and efficiency will be the key factors of sustainable growth.**
- Now that Moldova is perceived in the world as having a transition economy based on intensive use of primary factors, it becomes important to continue structural reforms and implement a model of economic development based on investment, innovation, export growth and diversification, both geographically and varieties.

During the post-crisis period, commercial banks become the main intermediary in the relation savings – investments, thus, their financial stability and functionality becomes a prerequisite in ensuring the country's sustainable growth.