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**Article**

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Journal for East European Management Studies

**Provided in Cooperation with:**

Rainer Hampp Verlag

*Suggested Citation:* Liuhto, Kari; Heikkilä, Marika; Laaksonen, Eini (2009) : Political risk for foreign firms in the Western CIS: An analysis on Belarus, Moldova, Russia and Ukraine, Journal for East European Management Studies, ISSN 0949-6181, Rainer Hampp Verlag, Mering, Vol. 14, Iss. 4, pp. 395-407

This Version is available at:

<https://hdl.handle.net/10419/84015>

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## **Political risk for foreign firms in the Western CIS – An analysis on Belarus, Moldova, Russia and Ukraine\***

*Kari Liuhto, Marika Heikkilä, Eini Laaksonen\*\**

*This report analyses the political risks of Belarus, Moldova, Russia and Ukraine from a foreign firm's point of view. Russia's increasing economic nationalism means increasing investment risk for foreign investors. The political climate in Ukraine is unfavourable to foreign investment but not to the extent that it would prevent or seriously restrict the possibilities of operating in the market. The political risk in Belarus is related to the centralisation of authority over economic policy. In Moldova, political risks for foreign investors are clearly present in this economically and politically problematic situation. All in all, political risk remains elevated in Belarus, Moldova, Russia and Ukraine*

*Der Beitrag analysiert die politischen Risiken in Weißrussland, Moldawien, Russland und der Ukraine vom Standpunkt eines ausländischen Unternehmens aus. Der gesteigerte wirtschaftliche Nationalismus in Russland bedeutet eine Erhöhung der Investitionsrisiken für ausländische Kapitalanleger. Das politische Klima in der Ukraine ist für ausländische Investitionen zwar ungünstig, aber nicht derart, dass wirtschaftliche Aktivitäten ausgeschlossen oder wesentlich eingeschränkt würden. Das politische Risiko in Weißrussland ist verbunden mit einer Zentralisierung der Autorität in Bezug auf die Wirtschaftspolitik. In Moldawien liegen die politischen Risiken für ausländische Kapitalanleger in der problematischen wirtschaftlichen und politischen Situation begründet. Alles in allem besteht weiterhin ein erhöhtes politisches Risiko in Weißrussland, Moldawien, Russland und der Ukraine.*

*Keywords: political risks, foreign firms, Belarus, Moldova, Russia, Ukraine*

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\* Manuscript received: 15.10.09, accepted: 16.10.09 (0 revision)

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## 1. Introduction

The main goal of this report is to analyse the political risk of these four markets from a foreign firm's point of view. The report consists of four independent chapters, which use a common conceptual approach in analysing the political risk of a foreign firm. Kari Liuhto analyses political risk in Russia (Chapter 2), Marika Heikkilä analyses the situation in Ukraine (Chapter 3) and Belarus (Chapter 4), and Eini Laaksonen analyses the risks faced in Moldova (Chapter 5).

## 2. Who doesn't risk, never gets to drink champagne- but how much one has to risk just to have a relaxed drink in Russia

**Government-related risks:** Russia is still developing democracy and its party system has not found its final form. An overwhelming concentration of power and a lack of genuine political debate prevail in Russia. Political parties play a secondary role, whereas the political limelights are occupied by the key political figures, who do not always represent the interests of their electorate but rather the interest of the state; be it that of the presidential administration, the government or some of the many security-related organisations. This elite repression does not exist in a large scale, but the prolonged hegemony of the ruling party (United Russia) may create situation where real political alternatives are no longer available.

The opinion polls show that the approval ratings of both the president and prime minister are exceptionally high, and therefore, one should not argue that elite illegitimacy exist in Russia as such. However, the main source of the illegitimacy originates from the fact that the State Duma lacks true opposition with an alternative political direction. The likelihood of immediate regime change is extremely low, even if the crisis has touched the Russian economy hard. Despite the prime minister having been forced to take unpopular decisions, the crisis has not collapsed the prime minister's popularity.

Russia's involvement in international organisations is not to become more active in the near future, on the contrary. For instance, Russia's over 15-year long road towards WTO membership received a rather surprising turnaround in June 2009, when Putin informed that Russia will join the WTO as a part of a customs union with Belarus and Kazakhstan. Russia's WTO decision means an end (at least a temporary one) to the negotiations aiming towards the creation of the Common Economic Space between the EU and Russia.

Russia confronts the USA especially in NATO enlargement to the CIS and Russia's goal to implement its sphere of influence in the CIS. Correspondingly, Russia's relations with the EU have cooled down, particularly after the Georgian war and the gas dispute with Ukraine.

In May 2008, Russia introduced the law restricting foreign investment into strategic sectors. The law was not prepared with sufficient time, and even Russian experts admit that there are several weaknesses in the law. Due to the global financial crisis, it is extremely likely that Russia will build customs barriers to protect its own industries. Since Russia decided not to join the WTO in the foreseeable future, it is very likely that several protectionist measures will be maintained, even after the crisis has ended.

**Society-related risks:** Though 80 per cent of the people living in Russia are ethnically Russians, one can argue that Russian society has become more fragmented and nationalism grows. Russia's increasing nationalism means increasing investment risk for foreigner investors, since the authorities are not able to fully control nationalism, nationalism encourages separatism, and finally, foreign business is a stranger, i.e. a target for attack if the nationalistic waves ever overflow the dam.

The world's public opinion towards Russia has become more reserved during this decade, when Russia began to rebuild its political and economic leverage in the post-Soviet territory. After three gas transit conflicts with Belarus and Ukraine the public image of Russia has particularly deteriorated in the West. After the war with Georgia and the increased assassinations of journalists investigating the Chechnya conflict, public opinion on Russia has dropped to its record low. The Russian Government should take seriously the deterioration of public opinion on Russia around the world. It might well be that the prolongation of the crisis in the Caucasus and the cooling of Russia-Ukraine relations may lead to a situation that public opinion prevents some of the Western companies investing in Russia.

**Economy-related risks:** Russia's GDP per capita growth has been remarkable in this decade. Until the crisis broke, the average growth was clearly above 5 per cent annually. Though the Russian GDP has nearly doubled in this decade, some citizens have been more equal than others in amassing prosperity. The richest 10 per cent of the Russian population earn over 30 per cent of all the income distributed in Russia, while the poorest 10 per cent earn less than three per cent.

The current crisis will add to regional inequality since there are hundreds of towns in which one corporation is practically responsible for the economic well-being of the whole city. The substantial increase in regional unemployment, and hence, the considerable drop in economic well-being will obviously cause social turbulence Russia has not seen since the beginning of the 1990's.

Many of the strategic economic goals cannot be met without a considerable re-direction of investments from natural resources to a knowledge economy, a true renaissance of entrepreneurship, and free and fair competition. One should not be fooled by the GDP growth of this decade, since the foundations of the growth

originated from high natural resource prices and larger export volumes of the natural resources.

Russia's balance of payment and currency stability is a multisided issue. Due to the global crisis, the prices of Russia's main export commodities have dropped, and hence, the country's massive foreign trade surplus is melting rapidly. Besides, Russia's budget deficit will be considerable in next few years. The forthcoming couple of years will be extremely challenging for the federal budget. However, in the medium run, the situation will be relaxed, since the oil price will obviously climb after the crisis is over. On the other hand, Russia's economy is still relying too much on oil, and therefore, in the long run, Russia has to get a rid of this dependency before its reserves run out and the world reduces its hydrocarbon dependence. The window of opportunity is open for some decades, not for several generations.

**Conclusions:** The probability of regime change is extremely low even if the crisis has touched the Russian economy hard. Though I cannot foresee any true regime change in the near future, one should keep in mind that the statist approach has gained weight in Russia. The prolonged instability of Chechnya has turned the Caucasus into fertile soil for Islamist fundamentalism. Should the Russian Government be unable to normalise life in the Caucasus region, one may anticipate that Islamist fundamentalism does not only spread inside the Caucasus, but fundamentalism may find its targets outside the Caucasus.

That Russian society has become more fragmented and nationalism grows. Increasing nationalism equals increasing investment risk for foreigner investors, since a foreign investor is a stranger and a target for attack if the nationalistic waves overflow the dam. The world opinion of Russia has substantially deteriorated during the year 2008. The Russian Government should take seriously the deterioration of public opinion about Russia around the world. The prolongation of the crisis in the Caucasus and the cooling of Russia-Ukraine relations may lead to a situation where public opinion prevents some of the Western companies investing in Russia.

The substantial increase in regional unemployment, and hence, the considerable drop in economic well-being will obviously cause social turbulence that Russia has not seen since the beginning of the 1990's. The Russian leadership has stressed the importance of a stable currency and the country's international reserves are notable. However, the currency stability of the rouble seems to be artificial in the crisis conditions. It remains to be seen how the rouble reacts to the second wave of the crisis, which may come if companies are not able to pay their bank loans.

The aforementioned factors increase macro risk in Russia. In this context, one should remember that risks vary a great deal between the industries. Telecommunications is the most risky industry for a foreign firm at the moment.

The main reason for turbulence is the Russian Government's decision to make Svyazinvest a state-owned national champion in telecommunications. If the state swallows up the ownership of Swedish- Finnish TeliaSonera (MegaFon) or the Norwegian company (VimpelCom), it would mean that Russia has taken another step in destroying its investment climate.

State consolidation in the oil and gas business has continued. The position of foreign oil firms varies. On one hand, the Russian Government offers some foreign oil companies stakes in new fields. On the other hand, the Russian Government has pushed some companies into a corner. The oil and gas business in Russia more follows the logic of international politics than international business, and hence, every step in the sector is shadowed by political risks. When Russia experiences difficult times, foreign oil companies enjoy good times in Russia, and vice versa, and therefore, the current crisis gives, at least, a temporary relief for some foreign oil firms.

I predict that the metal industry will also see its national champion in the aftermath of the crisis. The question is not whether the champion will be created but rather, when it will be carried out, which companies will be involved, and who will have controlling ownership in the national champion. Even if the metals champion will eventually be created, its direct impact on the position of foreign metal companies is not tremendous.

The production of electrical energy is a strategic sector, though it was not explicitly named in the law of strategic sectors. Even if major regime change is unlikely in medium term, the regime may become less foreign business-oriented and that would be an undeniable risk for foreign investors in the electricity sector, since the investments are large and a foreign firm is not able to take the electricity producing unit with him, if the company is squeezed out of Russia.

Some foreign forest companies have invested considerably in Russia, and they have been relatively successful in their investment. However, forests are widely considered as national prosperity among the Russians, and therefore, foreign ownership is risky, particularly if nationalism raises its head.

Although the financial crisis arrived to Russia from the West, Russia aims to attract foreign banks and bankers to the country, since its goal is to make Russia one of the financial centres of the world. Foreign banks' weakened financial position has, however, slowed their move to Russia.

According to a Russian saying, who doesn't risk, never gets to drink champagne. On the other hand, one should keep in mind that risk maximisation is not synonymous with profit maximisation, and therefore, the majority of the foreign businessmen would prefer to have a relaxed drink instead of playing Russian business roulette in order to get champagne.

### **3. Winds of change in Ukraine - The implications of politics for foreign investors**

**Government- and society-related sources of political risk:** Ukraine is one of the most interesting emerging markets in Europe. It is the home of 47 million consumers and a well-educated, competitive workforce. Furthermore, Ukraine is situated in a geopolitically strategic gateway location between Asia and Europe - at the very cross-roads of East-West and North-South trade routes. Ukraine is, however, equally known for its tumultuous political life since the break-up of the USSR. In 2005, the people of Ukraine marched to the streets protesting a rigged election in a peaceful demonstration, which would be known as the Orange Revolution. In the height of the Orange Revolution, Ukraine seemed to have shed its authoritarian past and moved toward a more democratic future, but the current economic and political situation in Ukraine is far from stable. Increasing political instability, coupled with a full burst economics crisis, poses new threats for foreign firm operating in this market.

Ukraine is facing continuous political paralyse caused by political infighting. The current power elite are barely capable of solving the country's economic problems, whilst the opposition is unwilling to make moves in fear of getting the blame on the threshold of a presidential election. A likely scenario for Ukrainian politics, therefore, is the continuation of political struggles, lasting instability and a lack of consistency in policy making.

Major media outlets in Ukraine are owned by businessmen who have their own political interests. Furthermore, politics and business are intertwined. Ukrainian Members of Parliament are often also involved in business and their political positions allow them to contribute in decision making concerning not only the economy but individual firms as well. In the time of crisis, some steps backward in democratisation may occur, as politicians strive to ensure their positions in power. This might give room for growing elite illegitimacy in the form of media bias, but actual acts of elite repression are not expected.

The presidential election, scheduled on January 17th in 2010, will most likely bring a change of political regime in Ukraine. The battle for the Ukrainian presidency will be between Yanukovich and Tymoshenko. Yanukovich, supported by oligarchs and the East Ukrainian electorate, will most likely win the election. The presidential election will play an important role in the future direction of Ukraine's foreign policy and is therefore prone to carry a significant geopolitical impact. As the president of Ukraine, Yanukovich would most probably work to restore the Russia-Ukraine ties, which have been deteriorating during the post-Orange Revolution period of liberal pro-Western politics. He is, however, also in favour of approaching the EU, but objects to any cooperation with NATO. The Ukrainian nation is historically divided into two divisions: the Russia-leaning East Ukraine and Europe-leaning West Ukraine. The polarisation of the nation has not been a source of social unrest, but regional differences can

be seen in the voting patterns of the people and this will be especially eminent in the approaching presidential election.

Cooperation between the EU and Ukraine will continue, and new possibilities for deeper integration arose when Ukraine was accepted into the World Trade Organization. Membership in the WTO enabled the beginning of the negotiation of a free trade area between the EU and Ukraine. At the same time, the state of Russia – Ukraine relations seem to be at their worst since the collapse of the USSR, indicating a growing threat of external political violence in Ukraine. According to Bovt, the two countries are closer to war than ever before during the post-Soviet period and Russia could use military power to prevent Ukraine from falling into the sphere of Western influence. However, the stakes for Russia in a war with Ukraine are considerably higher than in the case of Georgia. For instance, 80% of Russian gas deliveries to Europe go through Ukraine, and interruptions in these deliveries would yield substantial economic losses.

**Economy-related sources of political risk:** The global financial crisis has pushed the Ukrainian economy into a deep recession. Ukraine's GDP is estimated to plunge sharply in 2009, followed by a slow recovery in 2010. The economic crisis puts considerable pressure on the state budget, the balance of payment and currency stability. The current account balance is increasingly negative and the domestic currency, the hryvnya, has experienced a substantial fall. Heavy private-sector borrowing in foreign currency complicates the situation further, as both individual and corporate lenders are facing significant troubles settling their instalments.

Government ineffectiveness to tackle the economic crisis leads to growing discontent from the people. The government is struggling to meet the set economic goals, due to the growing budget deficit. The risk of significant social unrest will grow due to the scale of economic problems combined with the underlying weaknesses of the political system.

Short-term planning and decision-making are characteristic of Ukrainian politics and creates a lack of consistency over policy-making. Short-lived governments are not committed to proceed with the previously defined policies, which leads to further delays in implementing reforms. The economic hardship may increase the tendency of the government to interfere in the economy. The government may implement resuscitation methods that have a negative impact on foreign investors.

The economic crisis provides a new incentive to privatisation. The participation of foreign investors in the privatisation of so-called "strategic" enterprises and monopolies requires the approval of the Parliament and the Cabinet, but no legal definition of these strategic sectors exists. It is important to note that influential

economic agents are active in the political process, fighting over the control of resources, which means that the privatisation process will not be transparent.

**Conclusions:** Based on the analysis in this article, it can be concluded that the political climate in Ukraine is clearly unfavourable to foreign investment but not to the extent that it would prevent or seriously restrict the possibilities of operating in the market. Political risk is only one of the high risk categories of operational risk in Ukraine and challenges for foreign firms in the Ukrainian market are caused, above all, by the generally undeveloped business environment. Political risk remains elevated in the medium term, but these risks are balanced by the potential for higher than average returns on capital.

#### **4. Cosmetic changes toward economic liberalisation? - An analysis of political risk in Belarus**

**Government- and society-related sources of political risk:** The path of Belarus since independence in 1991 till today has been somewhat different from other former Soviet states. Belarus has avoided political and economic turmoil by having a Soviet-style strong government and practising a type of market socialism. This strategy has brought stability, but also kept desirable foreign capital outside the country. The current economic crisis will challenge the Belarusian economic model of strong state interference and reveal the negative effects resulting from postponing economic reforms. Belarus is slowly liberalising its economy in hopes of integration to the world economy and more independence from Russia. Foreign direct investment could play an important role in the modernisation of the Belarusian economy.

The level of democracy in Belarus is scanty at best. The opposition is weak, consisting of small parties, which lack a unified front. The fact that the Belarusian media is strictly controlled by the state leaves the opposition with very limited resources to have its voice heard. Freedom of assembly by critical independent groups is limited and public demonstrations typically lead to the arrests of participants. Frequent acts of political repression have occurred under Lukashenko's rule. Lukashenko has been referred to as Europe's last dictator. This may be justified considering that he not only retains tight control over regional administrators, military, security and law enforcement bodies, but also uses this control to prevent any attempts to dislodge him from his position. Concentration of power to the presidency has reduced the role of political parties in the Belarusian political system.

Having a strong central government has made Belarus stable compared to e.g. neighbouring Ukraine, and this has brought Lukashenko genuine popularity among the people of Belarus. It is difficult to assess the nation's actual support for its leader, because objective opinion polls do not exist. In addition, no respectable alternatives to Lukashenko's administration exist at the moment.

Therefore, it is justified to state that political illegitimacy remains a problem until a functioning political party system, an independent media and free elections are established. A sudden change of regime appears unlikely even though the present economic hardship imposes pressure on Lukashenko's administration. The administration may take some tentative liberalisation steps aiming at maintaining Lukashenko in power, but it will bring only cosmetic change.

The world public opinion on Belarus - especially the Western world's attitude toward the Lukashenko administration - is rather negative. This does not have a direct impact on foreign investment in the form of disinvestment pressure, but it has placed Belarus in international isolation, especially from the West. Relations between Russia and Belarus, on the other hand, have remained tight after the collapse of the Soviet Union. Belarus is an important ally of Russia and has a significant role in Russia's western defence. Russia has rewarded Belarus for its loyalty with cheap energy, an open market for Belarusian products and notable stabilisation loans. These economic privileges have enabled Lukashenko to practice social and economic policies that supported his image as the indispensable leader of Belarus in the eyes of the electorate.

Lately, relations between Russia and Belarus have suffered from regularly arising tensions. Russia's decision to reduce some of the economic privileges enjoyed by Belarus, including increases on the price of gas sold to Belarus, acted as the trigger to the worsening of economic relations. Russia is clearly re-assessing the value of loyalty from Belarus and is less willing to subsidise the Belarusian economy. Nevertheless, preferential economic treatment from Russia to Belarus will continue, although it is set to slowly diminish. The disputes with Russia over trade policy have forced Belarus to develop closer ties with other countries. In search for alternative markets for its products, Belarus is warming up to the EU's attempts to increase political and economic cooperation in the former Soviet states and has agreed to become a member of the Eastern Partnership Programme. The warming of relations between the EU and Belarus is unlikely to result in deep integration, since it is contingent on democratic reforms.

**Economy-related sources of political risk:** The economy of Belarus is tightly under the government's control. The Ministry for Foreign Affairs of the Republic of Belarus describes the Belarusian model of socio-economic development as "evolutionary, based on active government involvement in overseeing market relations".

Economic growth in Belarus in the 21st century has been impressive, reaching an average annual GDP growth rate of over 8% during the years 2001-2008. Since then, the economic crisis has extended to the export-oriented Belarus, and the prospects for 2009 are negative. Moderate growth is expected to begin in 2010. The economic hardship increases the potential for protest. The popularity

and legitimacy of the government derives from the prioritisation of social goals, but under the current economic strains, the government is forced to cut back on some of the subsidies to producers and consumers. Unemployment will inevitably grow, while wage growth is likely to stall or reverse.

The current economic difficulties of Belarus clearly signal the need for economic reforms, but the government is likely to avoid far-ranging economic restructuring or deregulation, because it could be politically risky. The government's solution to the situation seems to be to delay the necessary reforms by borrowing from abroad. The International Monetary Fund has granted Belarus a stabilisation loan of nearly USD 2.5 billion to overcome the economic crisis. The terms of this loan, however, require Belarus to liberalise its economy, and therefore the current economic troubles could actually have a positive impact on the economic development of Belarus in the long term.

The economic crisis has also given a new incentive to privatisation and the Ministry for Foreign Affairs of the Republic of Belarus has announced government plans to e.g. create over 500 joint stock companies through privatisation. Open privatisation transactions would, however, allow Russian investors to take over Belarusian assets, and therefore it is highly unlikely that strategic petrochemical and machine-building firms would be offered for sale.

Belarus is attempting to increase foreign direct investment and has adopted a list of liberalisation measures aimed at smoothing the running of a business and to simplify the requirements and regulations for business. A number of regulatory reforms took place in 2008 resulting in major improvements in the ease of doing business, but many challenges continue to restrict investment opportunities in Belarus. The investment climate in Belarus suffers from several problems regarding e.g. the legal system, tax regime, price controls and lack of an independent judiciary.

**Conclusions:** All in all, Belarus is politically and economically more stable than many other CIS countries, such as neighbouring Ukraine. Therefore, the political risk of a foreign investor in Belarus is related to the centralisation of authority over economic policy - rather than political instability - and the lack of guarantees for the consistency of the rules of doing business. Foreign firms operating in Belarus need to prepare for insufficient guarantees of fair and effective procedure from the government's side. Political risk for long term investment projects in Belarus is extremely high. Despite this, the actual level of FDI in Belarus may be below its potential and is likely to grow rapidly in the future.

## **5. The curious case of Moldova – Looking to the future, stuck in the past**

**Governmental and societal political risks:** The political environment in Moldova has been rather unstable during the past year. The Communist Party (PCRM), which had ruled the country for eight years, lost the majority of the seats in the parliament in the repeat elections on July 29th 2009 as the four liberal opposition parties, the Moldovan Liberal Democratic Party (PLDM), the Liberal Party (PL), the Democratic Party of Moldova (PDM), and the Alliance Our Moldova (AMN), altogether won the majority of the seats. The four liberal parties formed a coalition entitled Alliance for European Integration (AEI) and intend, for example, to overcome the socio-economic crisis, foster economic development, decentralize the government, and achieve Moldova's European integration.

After serving the maximum of two presidential terms, President Vladimir Voronin resigned as acting president in September 2nd 2009, and the choice of the new president is right ahead. However, neither the Communists nor the four pro-Western parties will be able to elect a new Moldovan president on their own, as they lack votes of the 61-vote parliamentary majority needed to replace the outgoing head of state. If the Parliament fails to elect a new president, there is a high risk for the need of repeating the elections again. As a consequence, the AEI and PCRM are somewhat forced to cooperate to maintain their current positions.

For investors, the uncertainties about the new Parliament and the new president create risks related to the government's future courses of action. Currently the Communist Party seems to be willing to pursue its own interests over the common ones, which hinders the Parliament from starting to solve, for example, the economic problems that the country is facing.

When it comes to international issues, the question of the Transdnestria's breakaway region has become a large political problem. Russia, the EU, and several international organisations have been involved in the negotiations, but at the moment the continuing conflict seems to be about political issues between Russia and the West, and there are no signals of solution. The dispute creates risks for example in the logistics sector as the most important routes from Moldova to Russia and other East European markets go through the breakaway region. Also, in the telecommunications sector, the mobile phone business has suffered from Transdnestria keeping on jammers which prevent the mobile phone connections from working. Because of the dependency on both the West and the East, Moldova seems to be quite handicapped in solving the Transdnestrian conflict, which again is a threat to the country's security and economy. Involvement in international organisations stabilises Moldova's investment environment, but at the same time there are clear political tensions in

the country's foreign relations, especially when it comes to the considerations of memberships of the EU or NATO.

In Moldova, the society is politically strongly polarised, some towards the West, some towards Russia. Especially in Transdnestria, people strongly support Russia. The regional diversity and the incongruent political interests of the citizens result in fragmentation of the society and create considerable tensions. This was seen in practice after the elections in April 2009, when thousands of protestors gathered on the streets of Chisinau after the Communists had won the elections, and the demonstration burst into a violent conflict. Potential for social conflict remains because of the strong political polarisation and because of the worsening economic conditions, poverty, and criminality. Moreover, if the new Parliament fails to get the reforms forward and improve the living conditions of the people, the threat of social conflict remains topical.

Privatisation has been one of the cornerstones of the economic reform plan in Moldova. However, in certain sectors the enterprises still remain state-owned, and even some re-nationalisations have taken place. For example, in February 2009, the European Court of Human Rights (ECHR) decided that the Moldovan Government will have to pay more than EUR 7 million to a Belgian investor, whose hotel was renationalised without any compensation. After such cases, it is no wonder why foreign investments in Moldova have remained at a rather modest level. Re-nationalisations, government intervention, bureaucracy, and the lack of transparency are not attractive characteristics of a business environment.

**The economy-related political risks:** An economic decline followed the collapse of the Soviet Union, but GDP growth started in 2000 with a growth of 2.1%, and reached 7.2% in 2008. However, Moldova's GDP is still under its pre-transition level, and the GDP per capita is one of the lowest among the CIS countries. In addition, in 2009, the country has again faced an economic decline because of the financial crisis, and the short-term perspectives do not look promising.

As a result of the decrease in foreign currency inflows caused by the decrease in volumes of remittances, FDI, and exports, it is expected that the national currency, the Moldovan Leu (MDL), will depreciate by almost 20% until the end of 2009. Another cause of pressure is the budgetary deficit. A decrease in consumption and the effects of a shrinking economy in the real sector will cause a dramatic decline in public revenues, which will affect the government's capacity to meet its expenditure responsibilities. Privatisations and some unpopular reforms, such as an increase in taxes and excises, a reduction of infrastructural development projects, and diminishing transfers to local governments and other institutions, are to be expected. Without the help of international organisations, such as the IMF and the World Bank, Moldova

could face a serious economic crisis, as the payment of salaries and pensions would be blocked.

The government already has difficulties in meeting its expenditure responsibilities, not to mention the goals to improve the business climate, regulation, and infrastructure. Foreign companies investing in Moldova will currently face a corrupted business environment with complicated regulation and taxation systems. The growth of FDI flow and stock has been stable since the year 2000, but the investment volumes have been rather modest. Most of the FDI has been targeted to the trade sector, and from Finland there have been investment flows at least to the telecommunications sector. In the next few years, the growing service sector (especially banking) is likely to be the most interesting investment target for foreign investors. However, political risks for foreign investors are clearly present in Moldova in this politically hectic and unstable situation.

**Conclusions:** At the moment, the investment environment in Moldova is rather challenging for foreign investors, mainly because of the political risks. The most significant risks are related to the current political instability – what kind of a government and what kind of a president will lead Moldova and to which direction? The country needs a government that can create a stable business environment where domestic and foreign investors can benefit from the country's gateway position between the East and West. I assume that in any case, changes for the better will not take place very fast because of the serious economic and societal problems and because of the country's complicated international relations. However, if the new democratic coalition manages to get the Parliament functioning, despite the currently cooperation-reluctant Communist Party, there is a chance for a turn to better. Determined and democratic governance is needed so that the country can leave its past behind, look to the future, and start anew.