

## Economic Growth Through Competitive Advantage and Specialization: the Example of Winemaking in Moldova

Prof. Dr. Tatiana PÎȘCHINA

ASEM

Romeo Fortuna, PhD candidate

### Abstract

This article addresses growth through economic specialization based on competitive advantage. Winemaking is one of the key branches of Moldova's economy, which stands for about 20 percent of Moldova's GDP. It has high potential in terms of contribution to qualitative economic growth. About 90 percent of Moldovan wine is intended for export to countries like Great Britain, Germany, Czech Republic, Poland, Greece, Scandinavia, US, Japan and China, and only 10 percent for local consumption. Winemaking is one of Moldova's specialties, which enjoys long-lived traditions and vivid history of Moldova's wineries, including Milesti Mici registered in 2005 as world's biggest winery by Guinness World Records. The concept of this study suggests that economic growth must be induced through competitive areas of specialization, which are present in any economy. Substantial investments are required to develop those areas. Structurally, winemaking branch in Moldova is comprised of small and medium enterprises flexible and open to innovation, which is a strong prerequisite to develop those areas into drivers of economic growth eventually resulting into new jobs, higher export, higher GDP, better living conditions. Winemaking alone cannot be the answer to Moldova's economic problem. Yet, this study highlights the importance of focusing on competitive advantage and specialized growth to create qualitative internally-driven economic growth, particularly important for nations struggling within current socio-economic affairs.

**Keywords:** Economic Growth, Competitive, Advantage, Specialization, Winemaking, Moldova

### Introduction

#### Competitive Advantage and Specialization

The character and implications of globalization to the modern world, as well as its controversy (Birdsall, 2006; Stiglitz, 2012; Lenzner, 2011) require a fresh approach of economic growth particularly when it comes to developing nations. Such economies are in constant balancing act between national interests supported by the national authorities, on the one hand, and the international perspective carried by such organizations as World Trade Organization, International Monetary Fund, World Bank and others. Balancing of economic interests concerns such areas as structural priorities between various branches of the economy, as well as economic specialization. Specialization policy, in its turn, defines the effectiveness of production allocation between industries and various branches of the economy and other financial activities, therefore, affects economic growth and optimization of development potential in context of opportunities and pressures posed by globalization (Pischina, 2007, p.81). Wise specialization decisions should be balanced through the principles of comparative advantage, the principles which theoretically define basic dimensions and logic of specialization (Porter, 1985). As the result, specialization can contribute to the effectiveness and increases in productivity, to the optimization of balance of payments, and finally to the competitiveness of national economy. Slow pace of economic growth is often explained by insufficient participation in international trade. The theory of comparative advantage states that national consumption can be boosted not only by means of expanding or strengthening the internal factors, but also through participation in international trade and specialization within international division of labor, which expands the boundaries of national production capacities. Thus, the policy of concentration on the industries and products that form competitive advantage of a nation positively contributes to the structure of the demand, the structure of external trade and production factors of the trading partners, and finally, to the rate of economic growth.

Economic effectiveness with which individual nations are able to produce various goods is changing overtime. Movements in allocation of resources and technologies lead to the movements in specialization, and therefore, to changes in relative

effectiveness of production of individual economies. For instance, innovation in research development and production of synthetic fibre and artificial rubber radically altered the structure of production resources whereby increasing relative manufacturing effectiveness of those products and goods produced on their basis.

It is generally accepted that the more a factor is specialized (concentrated) in export production, the more it benefits from foreign trade. Conversely, the higher the share of the factor in the products competing with imports, the more it loses in trade. It is also believed that owners of neutral factors (approximately equally represented in both export and import substitution industries) generally benefit from foreign trade, as the country's aggregate gain from foreign trade is accompanied by an expansion in demand for these factors, especially if they can move between the sectors of the economy.

Modern economists largely modify the classical theory. The theory of factors forms the basis for quantitative models and schematics of comparative costs, carried out in the works of Clement and Springerborg (2001), Clement and Skocpol (1979), as well as P. Elsworth, C. Kindlebner, J. Mide, R. Harrod and others. According to their theories, international trade is based on rational mutually beneficial principles profitable for all participating actors. Perhaps true for the developed economies, the same is not necessarily applicable to their developing counterparts. Developing and developed nations are usually characterized by major differences in the living standards, as well as effectiveness in production and labour. Conditional upon those differences, the benefits of foreign trade for the developed economies increases, whilst profitability gains on import of the developing ones are usually limited, coupled with the fact that foreign debt for those trading partners usually increases.

Thus, developing economies should be specifically careful to observe and exploit their own national specific advantages. This means that the goals and gains from specialization directly relate to the abilities and limitations defined by the national peculiarities, the level of its economic development, as well as its socio-economic policies. In addition, regional component helps to identify both strengths and weaknesses of the national economy, and to define economic branches that may have competitive advantages.

A relatively small number of market economy laws operate in specific or somewhat peculiar economic circumstances unusual for the economic behavior in which they normally apply, especially in conditions of uncertainty of individual economies in transition, showing new, previously unknown properties. Thus, the approach to growth creation and structural transformations for the developing nations must be designed carefully, and somewhat differently, in order to avoid creating economic structures harmful and often incompatible with the peculiarities of a given society and economy. Similar aspects were described in-depth in several papers by the author (Pischina, 2001, 2007, 2007a).

For the developing nations, it is important to take into account the principles of an integrated, systemic approach. According to this principle, we propose to consider all processes, including specialization processes. Objectively, the economy of each country is part of a single global economy, which in its essence is a large closed planetary economy. The processes occurring in any part of this whole are interrelated, interdependent and affect each other and socio-economic interests of one another.

Economic strategy for developing countries must involve the definition of their niche in context of globalization that is based on reasonable considerations taking into account specialization and being able to exploit its advantages for obtaining certain benefits. Developing countries should learn how to effectively develop in conditions of international competitiveness, while preserving their uniqueness primarily in specialization of industrial and economic branches (Pischina, 2007, 2007a).

### **Specialization: The Example of Winemaking in Moldova**

Winemaking is one of Moldova's specialties, which enjoys long-lived traditions and vivid history of Moldova's wineries, including Milesti Mici registered in 2005 as world's biggest winery by Guinness World Records. The concept of this study suggests that economic growth must be induced through competitive areas of specialization, which are present in any economy. The most important branches of the specialization of the Republic of Moldova are viticulture and winemaking. This set of industries forms 20 percent of the gross domestic product (GDP) of the country. The Republic of Moldova is one of the 70 nations with sophisticated wine-growing and winemaking complex, and the only country in the world that exports over 90 percent of the wines produced. Viticulture and winemaking have been the main activity of Moldovan population for many decades. According to the International Organization of Vine and Wine (OIV), the Republic of Moldova ranks 20th among the world's leading wine producers and as the 13th global wine exporter.

**Table 1: Wine Production in the Main Producing Countries (excl. juice and musts), 2017**

<i>Unit: mhl</i>	2013	2014	2015	2016 Provisional	2017 Forecast	2017/2016 Variation in volume	2017/2016 Variation in %	Ranking
Italy	54.0	44.2	50.0	50.9	39.3	-11.6	-23%	1
France	42.1	46.5	47.0	45.2	36.7	-8.5	-19%	2
Spain	45.3	39.5	37.7	39.3	33.5	-5.8	-15%	3
United States (2)	24.4	23.1	21.7	23.6	23.3	-0.3	-1%	4
Australia	12.3	11.9	11.9	13.1	13.9	0.8	6%	5
Argentina	15.0	15.2	13.4	9.4	11.8	2.4	25%	6
China*	11.8	11.6	11.5	11.4	11.4	0.0	0%	7
South Africa	11.0	11.5	11.2	10.5	10.8	0.3	2%	8
Chile	12.8	9.9	12.9	10.1	9.5	-0.7	-6%	9
Germany	8.4	9.2	8.9	9.0	8.1	-0.9	-10%	10
Portugal	6.2	6.2	7.0	6.0	6.6	0.6	10%	11
Russia*	5.3	4.9	5.6	5.6	5.6	0.0	0%	12
Romania	5.1	3.7	3.6	3.3	5.3	2.1	64%	13
Brazil	2.7	2.6	2.7	1.3	3.4	2.1	169%	14
Hungary	2.6	2.4	2.8	2.8	2.9	0.1	3%	15
New Zealand	2.5	3.2	2.3	3.1	2.9	-0.3	-9%	16
Greece	3.3	2.8	2.5	2.6	2.5	-0.1	-5%	17
Serbia*	2.3	2.3	2.3	2.3	2.3	0.0	0%	18
Austria	2.4	2.0	2.3	2.0	2.4	0.4	23%	19
Moldova	2.6	1.6	1.6	1.5	1.8	0.3	20%	20
Bulgaria	1.7	0.7	1.3	1.2	1.2	0.0	-2%	21
Georgia*	1.0	1.1	1.3	1.1	1.1	0.0	0%	22
<b>OIV World Total(3)</b>	<b>290.1</b>	<b>269.5</b>	<b>274.7</b>	<b>268.8</b>	<b>246.7</b>	<b>-22.1</b>	<b>-8%</b>	

(1): Countries for which information has been provided with a wine production of more than 1 mhl

(2): OIV estimate based on USDA info

(3): OIV estimate: mid-range estimate. Range for evaluation of 2017 world production: from 243.3 mhl to 250.1 mhl

Source: OIV

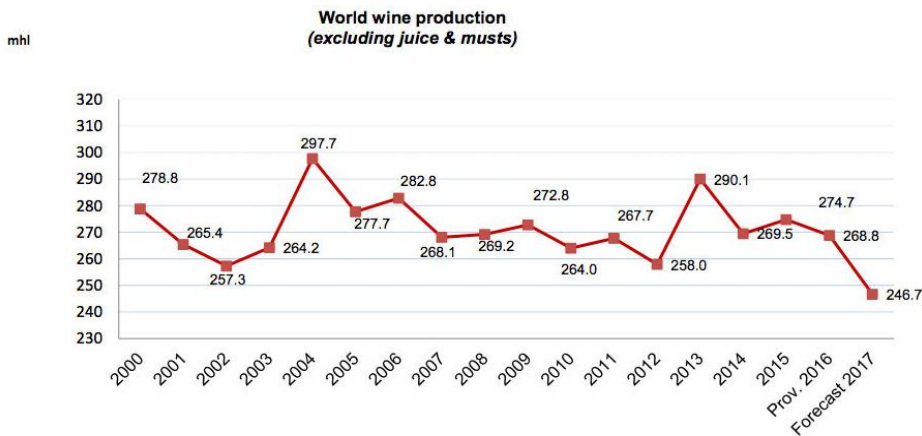
In 2017, Moldovan wines were exported to 42 countries for almost \$104 million, exceeding \$93 million in 2015. Most wines from the Republic of Moldova were sold in Belarus (20 percent), as well as in China (9.5 percent), Romania (7.5 percent), followed by Russia, Ukraine Czech Republic. Moldovan wines won about 300 medals at international competitions, 60 percent out of which were gold.

From the 1960s to approximately 1980s Moldova's plantations of vineyards and assortment of manufactured products expanded. At that time, Moldova was the main supplier of wines to USSR, when every second bottle of wine, and every third bottle of sparkling wine in the Soviet Union was produced in either in Moldova or using Moldovan wineries. In the heyday of winemaking industry, the territory covered with vineyards in Moldova was more than 220 thousand hectares, where roughly 1.1 million tons of grapes were harvested, and more than 42 million hectoliters of wine were produced (*Wine-making and Viticulture, 2017*).

In the mid-1980s, Moldova's winemaking industry experienced a rough period under the so-called 'dry law' as part of the national fight against the addiction to alcohol. Dozens of hectares of grapevine, as well as valuable wine, were destroyed in that period. Production areas were reduced more than 3 times, and priceless stocks of wine, crops and winemaking technologies were destroyed. Handling of the matter by the authorities resulted more or less into a national tragedy, encompassing cultural, but most importantly economic damage from conglomerates to single households whose income was in producing and selling wine (*Wine-making and Viticulture, 2017*).

Today the total area of vineyards in Moldova is 147 thousand hectares, including 113 thousand hectares of commodity plantations. Over 95 percent are privately owned. Currently, Moldovan winemakers produce over a hundred of various types of grapes, covering the European varieties to about 70 percent, Caucasian varieties to about 14 percent, as well as local varieties of about 16 percent. In 2017, Moldova produced 8 million hectoliters of wine, which is 20 percent increase over 2016, that is while the global wine production trend is negative, as seen in the Table 2 below.

**Table 2: Trends in Global Wine Production**



Source: OIV

International Vine and Wine Organization (OIV) notes that global wine production decreased by 8.2 percent in 2017, reaching 246.7 million hectoliters, the lowest level since 1961. The global decline in wine production is caused by various factors, including unfavorable weather conditions in three major wine producers in Europe: Italy, France and Spain. According to the estimates of OIV, Italy's production decreased by 23 percent to 39.3 million hectoliters, France's production decreased by 19 percent to 36.7 million hectoliters, and in Spain - by 15 percent to 33.5 million hectoliters. The statistics, however, exclude China, which is the 7<sup>th</sup> global winemaker.

In 2002, Moldovan government adopted the Program for the Restoration and Development of Viticulture and Winemaking for 2002 - 2020 (Government Decision No. 1313 of 07.10.2002), with the aim to strengthen and integrate viticulture and winemaking. The initiative helped to start revitalizing the industry and the branch of winemaking. Many winemaking enterprises emerged, investing not only in modern technologies and equipment, but also in planting vineyards, helping to form an agro-industrial winery complex – cluster. The rebirth of winemaking started to positively affect the economy as a whole. In this way, small and medium-sized enterprises emerged as the driving force behind the development of the winemaking cluster, as well as the entire economy of the Republic of Moldova. Those often family-owned companies support and develop the traditions of viticulture and winemaking, and also are among the main generators of job-creating and subsequently economic growth.

Small enterprises have certain advantages in comparison with the large ones. For example, they are less inert compared to large enterprises, more adaptive to innovative technologies. In a market characterized by intense competition, small and medium-sized enterprises are quickly adaptable and able to respond in a more flexible way to structural, market and economic changes. However, small and medium-sized enterprises have their vulnerabilities. They are at risk of financial strain, shortage of production capacities, and relatively small research base. Yet, not only in Moldova, but globally, small businesses are at the forefront of the wine industry, combining innovations with tradition. For example, in France, small to medium sector accounts for half of annual wine production, 54 percent of vineyards and 77 percent of permanent workers. That is to say, in Europe, 210 thousand small wineries united in national associations, which formed the European Confederation of Independent Wine-Growers (CEVI). In Australia and New Zealand, 80 percent of all wine producers are small. Among them there are many enterprises producing organic wines. Their role is not only in promoting wine, wine tourism and other activities associated with winemaking, but also in creating jobs. Thus, the role of such enterprises in the total economy, especially a developing economy like Moldova, cannot be overestimated. Nevertheless, the amount of small wine producers in Moldova is still relatively small.

### Challenges of Moldova's Wine-making Cluster

The EU regulatory framework assumes a definition of small wine producers with the criterion being the volume of production (on average 1000 hectoliters per year). In most winemaking economies special legal norms have been established to support small wine producers. General rules have been adopted to ensure fair competition in the industry. Taxation and

the licensing costs are reduced, registration is simplified, and subventions and special funds for promotion are established. Similarly, in the United States, taxation for the small enterprises that produce less than 250 thousand gallons (950 thousand liters) is normally reduced. In Slovenia, an enterprise that has no more than 1 hectare of vineyards and produces less than 80 hectoliters of wine per year is considered small. The amount of sanctions for various violations depends on the manufacturer's category, and promotion subventions for small and medium-sized wineries reach 52 thousand euros per year for three consecutive years (MSWPA, 2010).

Unfortunately, Moldova's legislation does not assume a separate regulation supporting small enterprises and does not contain differences for small wineries. In general, the legal framework presents many obstacles. On the one hand, for over five year, the state allocated partial compensations for the planting of vineyards (including involving small enterprises in the process), but on the other hand it did not provide their owners with formal opportunity to produce and sell wines made from the crops grown on these plantations. Nevertheless, small wineries are carriers of tradition and quality. They form a real potential, which should be both supported and exploited.

In particular, small wineries find it difficult financially to fulfill the conditions for obtaining a license. The cost of the license for all wineries in Moldova is the same, standing for 20 thousand lei per year (the amount is one of the largest in the world), which contradicts the principles of fair competition. The conditions include owning own warehouse with an area of at least 500 square meters with fully digitalized accounting system (often the area of the whole enterprise is smaller) and own production capacities, including equipment for processing wines with cold, heat, filters, bottling line, laboratory with licensed personnel, trade-marks, labels approved for the respective product range. In general, most mandatory requirements are irrelevant in conditions of market economy. In many European economies, such as France, Spain, Italy, Austria, smaller winemakers in particular do not need a license for wine production. In Australia and New Zealand the license is only needed for export. Instead, other regulation models are used for registration in the wine-growing and winemaking industry, for instance, through the obligation to register plantations in the Vineyard Cadaster and wine production in the Register of Wine Producers.

Small producers are exposed to greater risks, not only financial, but also in terms of exposures, such as to climate conditions. In order to support smaller enterprises so important for economic growth, the state must share the risk and minimize exposure.

Moldovan winemaking is very attractive for potential foreign investors. A significant number of projects are being implemented in this particular industry branch. Every year the total number of wineries in the Republic grows, increasing from 120 in 2002 to 165. New plants are created not only with the help of companies and their external trading partners, but also attracting loans from both Moldovan and foreign banks and funds. Investors from France, Germany, Russia, the Netherlands, Belgium and the US recognize the potential of the wine industry of the Republic of Moldova and establish joint ventures with local companies.

Presently, Moldova's winemaking industry is focused on the efforts of the dedicated specialists, the enterprises and the state as a whole on the new vineyards, on control of the quality of raw materials, training of the specialists in line with modern production technologies, while acquisition and application of modern equipment takes place.

Moldova, which is part of the WTO, has all relevant laws regulating the activities of the industry. The wine is produced in conjunction with the European classification: high quality with a name reflecting duly controlled place of origin (VDO) and (VDOC). Moldova's wines are known in the CIS countries, as well as in the Baltic States, England, Ireland, Germany, Holland, Israel and other countries. As already mentioned, about 90 percent of wine production is intended for export, and only 10 percent is sold on the domestic market. The volume of exports in recent years is estimated at 1.3 to 2 billion lei (90-150 million US dollars). However, the Republic of Moldova has not yet managed to reach its pre-economic crisis sales volumes.

Objectively, the potential of the Republic of Moldova to develop viticulture and winemaking and to improve the quality of the wine to the level of highest global standards is quite large. In case of winemaking industry unique in its organizational structure, investments are needed in innovation of technology supporting wineries, crops, tools, in other words, the entire value chain to achieve highest quality of the end product at relevant profitability. Structurally, winemaking branch in Moldova is comprised of small and medium enterprises, which are flexible and open to innovation, which is a strong prerequisite to develop those areas into drivers of economic growth eventually resulting into new jobs, higher export, higher GDP, better living conditions. The activities associated with attracting the investments, the emergence of new plants and modernization of the old ones, with an emphasis on increasing the share of production of high-quality wines, will not only increase export volumes, but can also help conquer new markets and occupy new price positions. In addition, wine tourism, including winery

tours and promotion of Moldovan wine in conjunction with other events will help to raise the image of Moldova as a country in general.

### Conclusion

Specialization is a powerful tool for solving social, economic, environmental and energy security problems, as well as demographic changes, and limitations though natural resources. For the Republic of Moldova, it is an opportunity to strengthen the economy, which will allow Moldovan companies to compete internationally. Conversely, Moldova may continue its journey as a weak economy, and exporter of cheap highly qualified labor that the country itself is unable to take advantage of. Therefore, it is absolutely crucial to create common focus on exploitation of competitive advantages and specialization of the economy, at the same time supporting small and medium size enterprises to carry out activities building up to long-term economic growth.

In order to develop socio-economic potential of the nation, it is necessary to identify and use supporting mechanisms to reorient the production structure to specialization areas and to the international markets. This study highlights the importance of focusing on competitive advantage and specialized growth to create qualitative internally-driven economic growth, particularly important for nations struggling within current socio-economic affairs. As for specialization, winemaking is one important area the Republic of Moldova is known for. It is necessary for Moldova to focus specifically on realizing its competitive advantages, developing and strengthening traditional branches of specialization, in particular, viticulture and winemaking, to which its international partners can certainly contribute through investments and various partnerships. Implementation must be supported by the state, as only common effort will allow the tradition of winemaking to turn into profitable business.

The European Union, as one of Moldova's crucial trading partners, should more actively support initiatives aimed at the existing and the new businesses due to the benefit for the citizens of the Republic of Moldova and to the European community as a whole that those businesses will create. Winemaking alone cannot be the answer to Moldova's economic problem. Specialization and support for small and medium businesses operating across economic branches step by step would help reverse current negative trends of economic stagnation and brain drain. Investment and support must be provided in synergy between public and private sectors. Technology, human capital and financial and other highly profitable sectors remain crucial to address. Thus, the example of Moldova has broader relevance and is interesting for other developing economies, as well as for the representatives of international governmental and private sector organizations.

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