The Economy of Romania and Foreign Direct Investments

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Abstract

In the context of the market economy, foreign direct investments make an important contribution to economic growth. For Romania, foreign direct investments had a crucial importance both during the transition period and in the period following the achievement of the functional market economy status.

Although the foreign direct investment (FDI) stocks represent an important share of Romania's GDP, in the competition with the other former socialist countries which have joined the European Union, our country is situated below the level recorded by this indicator in all the 11 states analyzed. Given the positive effects generated by the FDI stocks, Romania still needs the contribution of foreign investors in order to evolve. The aim pursued in elaborating this paper was to highlight the positive impact of the flow of foreign direct investments on the economic growth in Romania and implicitly to emphasize the role that foreign investors can continue to play in the economic development of our country.

Key words: foreign direct investment, gross domestic product, multinational firms, competitiveness, economical growth

J.E.L. classification: F21

1. Introduction

A country needs financial resources so as to develop its economy. For the developing countries and the countries in transition, the financial resources needed for development can come from accessing long-term loans or they can take the form of attracted FDI flows. While it is essential that one option does not exclude the other, we can ask ourselves which of the two options should be prominent.

Although they increase the level of indebtedness, development loans allow to a certain extent to bring the future into the present, in the sense that there is no need to wait for a large number of years in order to have successive accumulations to ensure the necessary financial resources for economic progress. Moreover, governments can adjust development projects according to the specific conditions existing in each country. If the right thing is done and the general interests of the society are put first, then the beneficial effects generated by such an approach will be major. Unfortunately, reality has shown that in very many cases, due to incompetence or decision-makers' acts of corruption, the economic results were not as expected. In addition, the burden of over-indebtedness had to be borne by the respective nations for a long time.

Attracting FDI is the alternative that more and more countries have been relying on. For the host countries, foreign-owned subsidiaries or foreign-owned joint ventures have been significant factors in their economic development process. We keep in mind the fact that foreign direct investments are usually made for a long period of time, being difficult to abandon. On the other hand, the foreign investor has control in the company in which it invests and as such will manage it in such a way as to obtain profit. In addition to the technology it transfers to the host country, the foreign investor also ensures a flow of management, marketing knowledge, etc., which often has a beneficial impact on the local companies with which it interacts when conducting its business. The high level of the salaries collected by the employees of companies with foreign capital, the volume of taxes paid by these companies to the local or national budgets, their contribution to stimulating the exports of the host country are further arguments that can be taken into account when a government develops its own policy regarding FDI.

It is noteworthy that in the period following the Second World War there was a reluctance towards foreign investors in the context of the declaration of independence by a significant number of colonies. The new independent states which had gained their political independence also wanted a greater independence from an economic perspective, trying in this context to limit the economic ties with the former metropolises. After the '80s of the last century, the approach in the field changed radically, most countries of the world being favorable to attracting foreign investors, the regulations issued by those countries being an eloquent testimony in this regard. Exceptions were countries such as Venezuela, Bolivia or Ecuador, which took measures to limit or even block foreign capital inflow.

The objective of this scientific approach is generated by the need to emphasize the overall beneficial effects of FDI flows upon host countries. At the same time, the role that foreign direct investments have played in Romania's economic growth in the period since the fall of communism is also highlighted.

2. Theoretical background

The intensification of the globalization phenomenon of the world economy in the last decades has materialized, among other things, in a strong liberalization of the movement of goods and capital. The foreign investors were able to easily invest their capital in the countries that ensured the best profitability in the context of lower risks. Thus, a competition emerged for attracting as large a volume of FDI as possible, a competition which manifested especially among the developing countries or those in transition.

Both nationally and internationally, there are numerous authors who have analyzed and debated various aspects of the effects that foreign direct investments have on the host countries' economies.

Costea Munteanu carried out an interesting analysis on the role of the investment in the economy and the involvement of international companies in making investments abroad. Moreover, he addressed the policies in the field of FDI promoted by different categories of countries.

Viorela Beatrice Iacoboiu very accurately depicted the effects generated by foreign direct investments at the macroeconomic and microeconomic level, as well as the impact of these investments on the Romanian economy.

Alexandra Horobet tackled a number of issues related to the theory of risk and the quantification of the effects it generates. Also interesting is the attention given to the evaluation of the impact that FDI flows have on our country' economy.

Alexander Belohlavek highlighted the issue of foreign direct investment in the EU, focusing on aspects related to international law.

Federico Carril-Caccia voiced concerns about the evolution of the share of FDI stocks in GDP at the global and EU level, while emphasizing the increasing role of the emerging countries both in terms of the issuance and in terms of the absorption of foreign direct investments.

The statistical data made available to the public by the National Bank of Romania and the United Nations Conference on Trade and Development (UNCTAD) were also extremely important for capturing the evolution of economic phenomena.

3. Research methodology

Starting from the theoretical documentation of the established topic, through the methods and tools used, we have aimed to highlight the characteristics generated by the FDI flows of the Romanian economy.

Through the carried out quantitative research, we have set out to emphasize the existing connections between the analyzed phenomena.

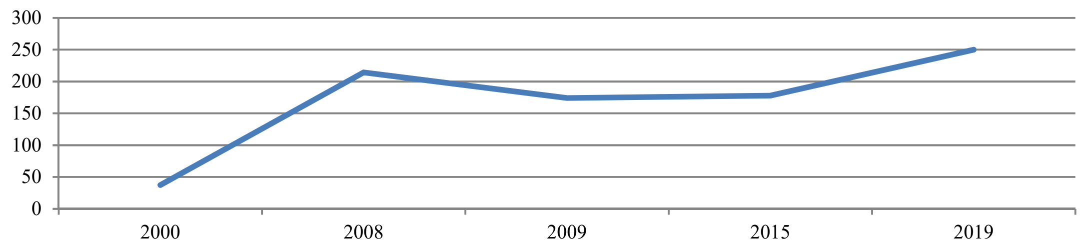
As a result of the comparative analysis regarding the effects generated by foreign direct investments in Romania and in the former socialist EU members, we have highlighted the dimension of the role that foreign direct investments play in the Romanian economy.

4. The evolution of GDP and FDI flow in Romania

In the period elapsed from the takeover of power by the communists until the events of December 1989, the Romanian legislation did not prohibit foreign investments in our country, however, it drastically limited them. Thus, foreign investments in Romania could materialize in the form of joint ventures in which the Romanian side had to have the majority. The consequence of this approach in terms of attracting foreign direct investment was the small number of joint ventures (with Romanian and foreign capital) that existed during the communist period, with negative consequences on the technological level of our country's economy and, implicitly, on the level of competitiveness of the Romanian products.

The fall of communism led to a fundamental change in the approach to foreign direct investment. The Romanian legislation, adopted immediately after 1990, allowed the access of foreign investments in Romania, granting important incentives in this respect. Moreover, for several years, for example, the facilities related to exemptions and reductions in income tax were clearly favorable to foreign investors, a discrimination being evident in relation to those granted to domestic investors. On the other hand, the political and legislative instability, the mineriads, the acts of corruption, the lack of transparency, the existence of a strong economic state sector, etc. were all factors which fueled the reluctance of foreign investors towards Romania.

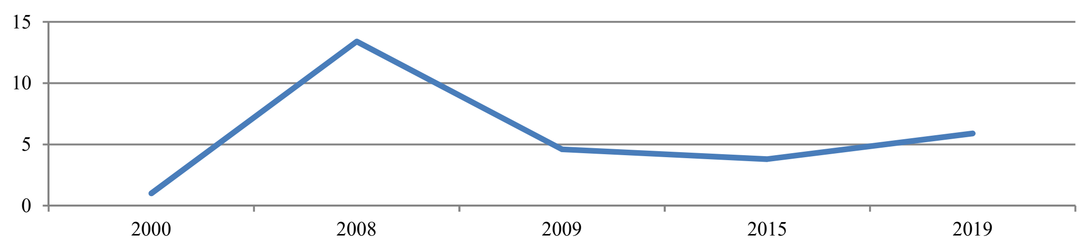
Figure no. 1. Romania's GDP evolution ($ billion)



Source: https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sCS_ChosenLang=en

Regarding the evolution of GDP and annual FDI flows attracted by Romania in the last 20 years, we notice that there is a certain similarity. Up to 2008, both GDP and FDI flows increased rapidly. The global financial crisis strongly affected both indicators, the amplitude and duration of the impact being greater in the case of the FDI flows attracted by Romania.

Figure no. 2 FDI flow attracted by Romania ($ billion)



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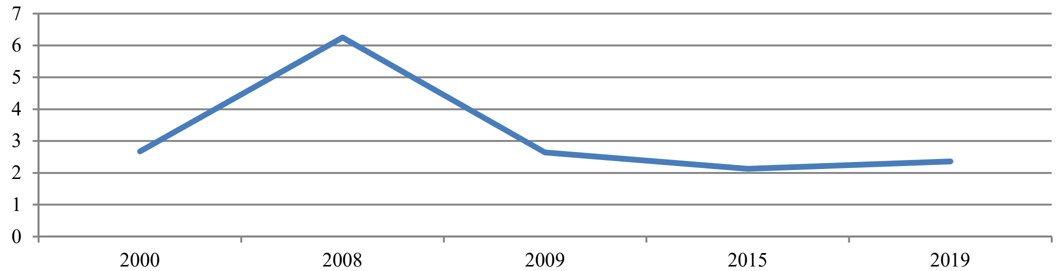
We must note the strong increase in the FDI flows attracted by Romania in the years preceding the last global financial crisis, due to the new positions achieved by Romania (NATO membership, EU membership), but also to the special privatization offer of those years.

The global financial crisis meant a substantial decrease in annual FDI flows for the entire period that followed. Although there have been some timid recovery tendences of the FDI flows, the levels reached by them are far from the levels recorded in 2006 or 2008. After a slight upward trend between 2015 and 2019, the impact produced by the pandemic crisis on the economy materialized in the reduction by 60% of the FDI attracted by Romania in the year 2020 compared to the level recorded in the previous year.

Figure no. 3 The dynamics of the share of attracted FDI flow in Romania's GDP (%)



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As a result of the decrease in foreign investment flows in the period since the global financial crisis, there has been a reduction in the impact that these annual flows have had on our country's economy. Thus, the share of annual flows in GDP decreased from 6.25% in 2008 to just 2.13% in 2015 and 2.36% in 2019. We can say that the substantial reduction in the opportunities provided by the privatization, the attitude manifested in some cases by decision-makers, the poor transport infrastructure, the deficits in human resources, etc. represent causes that led to the decrease in the volume of attracted investments and, implicitly, to the reduction of the effects generated by FDI in the Romanian economy.

For the entire analyzed period, we can conclude that the flows of foreign investments attracted by Romania have been at a lower level than the needs of our country.

5. The impact of FDI stocks on the Romanian economy

Most of the FDI stocks attracted by Romania until the end of 2019 (40.4%) went to industry. In this respect, Romania registers higher levels compared to the situation in the other countries in the area. Construction and real estate transactions (16.9%), trade (16.6%), financial intermediation and insurance (11.5%) were also areas of major interest for the investors who turned their attention to Romania. (BNR, 2019, p.10)

Although the FDI in the extractive industry represents only *4.4% of the total*, the exploitation of Romania's natural resources is mainly carried out by companies with foreign capital, an aspect which, in many respects, cannot be appreciated as positive. Things must be seen in the context in which Romania has considerable natural resources, at least in relation to the general situation in Europe.

Romania's successes are limited when we analyze the foreign direct investments made in knowledge-intensive activities.

It is not a coincidence that in terms of the competitiveness index, which takes into account macroeconomic stability, infrastructure, health, education's efficiency, labor market's efficiency, technological training, innovation, etc., Romania is found next to Bulgaria on the last places in the European Union.

Many of the foreign direct investments in Romania were of the greenfield type (61.8% of the FDI stocks attracted by Romania), thus contributing to the increase in Romania's production capacities and at the same time providing jobs for the domestic citizens. Furthermore, the salary level and the working conditions are clearly higher compared to those provided by the Romanian capital. It is edifying, in this sense, that multinational companies' investments per employee were double in volume compared to the investments per employee made by companies with Romanian capital. Unfortunately, in the last 10 years the average growth rate of the greenfield type of FDI stocks has been lower than the average growth rate of the total FDI stocks attracted by Romania.

Regarding the origin of the FDI stocks entered in Romania, most of them came from the Netherlands, Austria, Germany, Italy, Cyprus, etc. The surprising appearance of the Netherlands in the first position is noticed, which can be explained by the fiscal facilities in this country, many of the Dutch investments being, in fact, American investments. Also surprising is the position occupied by Cyprus, which has overtaken countries such as France or the United Kingdom. Given the tax haven qualities that Cyprus has shown more or less persuasively over time, the position that this country occupies in the top of the investors in Romania becomes reasonable. We are considering the possibility that some Romanian businessmen could be at the origin of the FDI flows made by Cyprus in our country.

In terms of distribution by development areas, the FDI stocks attracted by Romania were distributed mainly in the Bucharest-Ilfov region (62.7%) and the Center region (8.7%), at the opposite pole being the South-West Oltenia region (2.9%) and the North-East region (2.0%). This strongly asymmetrical zonal distribution of the FDI stocks denotes the weak contribution that foreign investors had in the direction of achieving that desideratum that aimed at diminishing Romania's development disparities in its territory.

The contribution that foreign direct investment companies have to the realization of Romania's foreign trade is more than remarkable. In 2019, the share held by FDI companies in Romania in total exports (FOB) was superior to the share held in total imports (CIF). At least in theory this situation should be satisfying.

In the case of goods, FDI companies account for 74.2% of total exports and 68.2% of total imports, but in absolute values there is a deficit of 6.7 billion euros. In terms of services, FDI companies hold a share of 49.9% of total exports and 41.7% of total imports, resulting in a surplus of international trade in services of 5.8 billion euros. (BNR, 2019, pp. 23, 24, 38, 39)

On the whole of the international trade in goods and services, we find that FDI companies registered a slight deficit in the year 2019 (almost one billion dollars). This trend has also manifested over the last decades, when Romanian companies resulted from foreign direct investments registered higher imports than exports every year, which has generated a constant trade deficit.

It is worrying that annually in the top 100 Romanian exporters there are only 3-4 companies with majority state capital, these being usually placed in the second half of the ranking.

6. Romania vs. the former socialist EU countries from the perspective of the FDI stocks' share in the GDP

The contribution of foreign direct investments to the formation of GDP, to stimulating foreign trade, etc. is obvious. Some personalities even consider that the Romanian economy is too dependent on the foreign capital, with all the shortcomings that derive from this state of affairs.

Table no.1. The comparative evolution of the share of attracted FDI stocks

		2000	**2010**	**2019**
FDI Stocks ($ billion)	Bulgaria	2.7	44.9	51.8
	Croatia	-	32.3	29.8
	Czech Republic	21.6	128.5	170.6
	Estonia	2.6	15.5	27.4
	Hungary	22.8	91.0	97.8
	Latvia	1.6	10.8	17.9
	Lithuania	2.3	15.3	19.5
	Poland	33.4	187.6	228.5
	Romania	6.9	68.6	97.0
	Slovakia	6.9	50.3	59.7
	Slovenia	2.3	10.9	16.7
	Total	103.1	655.4	816.7
GDP ($ billion)	Bulgaria	13.2	50.3	67.9
	Croatia	-	59.8	60.4
	Czech Republic	61.3	209.0	250.6
	Estonia	5.9	19.6	31.4
	Hungary	47.2	131.9	163.4
	Latvia	7.9	23.8	34.1
	Lithuania	11.5	37.1	54.6

	Poland	172.2	479.8	595.8
	Romania	37.4	166.2	250.0
	Slovakia	20.7	90.3	105.0
	Slovenia	20.2	48.1	54.1
	Total	397.5	1315.9	1712.3
Share of FDI stocks in GDP	Former socialist countries	25.9	49.8	47.6
	Romania	18.4	41.2	38.8
	Global	21.9	30.0	41.7

*Source:*https://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sCS_ChosenLang=en

In order to better highlight Romania's situation in this respect, we have considered it necessary to emphasize the evolution of the share of FDI stocks in Romania's GDP by making a comparison, on the one hand, with the global situation, and on the other hand, with the cumulative situation of those 11 former socialist countries which have since become EU members.

In terms of the share of the FDI stocks in GDP at the beginning of the analyzed period (2000-2019), Romania, with 18.4%, was slightly below the level reached on a global level (21.9%) and significantly lower in relation to the cumulative situation of the 11 former socialist states (25.9%). This position of Romania can be explained by the delays manifested in the economic reform process, the external perception of the domestic business climate, etc. Over time, the values recorded by Romania in this indicator increased, for example in 2010 our country slightly exceeded the level reached worldwide. Instead, in the year 2019 it largely returned to the values recorded in 2000. Thus, in the year 2019 the share of foreign direct investment stocks in GDP was 38.8% in the case of Romania, 41.7% - at global level and 47.6% - in the case of the 11 former socialist countries currently members of the European Union.

For Romania, the differences are even greater for this indicator when the comparison is made with countries such as Hungary (59.8%), the Czech Republic (68.1%) or Estonia (87.2%), the figures being valid for the year 2019.

Although the major role that FDI plays in the Romanian economy is obvious, we also take into account the situation recorded in the other former socialist EU countries and the current, concrete needs of our country's economy, the increase in the FDI flows attracted by Romania being a necessary phenomenon.

7. Conclusions

We can conclude that in the last decades there has been a real competition among the countries in terms of attracting foreign direct investments. China, Hungary, Poland are eloquent examples in this sense. We must also highlight certain changes in the perception of public opinion regarding the activity carried out by multinational companies. Through the subsidiaries they implant abroad, the multinational companies have proven over time to be the main providers of FDI. Regarded with reluctance by some, especially due to the increasing dependence of the national economies on foreign capital, and by others considered to be the main factor of economic development and rising living standards, multinational companies will always be a controversial topic. At present, the population seems to appreciate to a greater extent the aspects related to competitiveness that the multinational companies create, paying a little less attention to the negative effects that they induce in the economies of the host countries.

Although from the perspective of the share held by the FDI stocks in GDP, Romania occupies a lower position compared to most former socialist EU member states, the role played by FDI in the economic development of our country is obvious. Considering the evolution of the countries that did not join the EU, we can state that if Romania had remained outside the EU the FDI stocks would have been much smaller, thus having a negative impact on economic growth. At the same time, it is necessary to redirect the foreign direct investments attracted by Romania towards technology-intensive sectors, therefore setting the premises for carrying out high value-added activities.

The current reality, with all its shortcomings, seems to be favorable to Romania. The pandemic crisis has highlighted certain vulnerabilities of the European Union generated by the transfer of many production capacities into China. The pandemic context, the competitiveness of Romanian products in terms of price-quality ratio, the fact that over 70% of Romanian exports are destined for EU countries are all elements that could lead to the development of certain industries in Romania, including by attracting foreign capital.

An additional piece of evidence in this regard lies in the fact that Romania recorded in the first quarter of 2021 the highest economic growth of all EU countries, which should not go unnoticed by the foreign investors.

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