EVOLUTION AND PERSPECTIVES OF FOREIGN DIRECT INVESTMENT IN ROMANIA

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FDI is a key factor for economic modernization through changes in production patterns, technology transfer and greater competition pressures. In the latest years, Romania has benefited from important FDI flows, mainly due to the privatization process, but also due to the advantages of cheap labour force and a big internal market.

The issue to be addressed further regards the possibility of improving its attractiveness as host country for FDI in sectors generating higher added value and this refers to assuring a functional business environment, qualified labour force and a modern infrastructure.

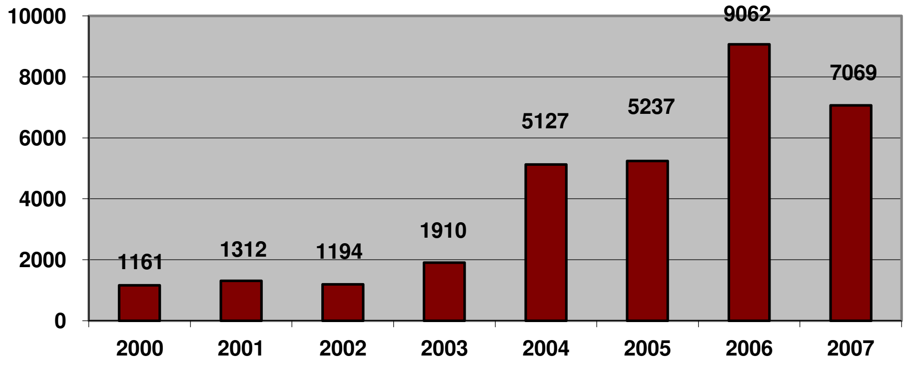
Key words: foreign direct investment, competitivity, business environment, qualified labour force

From the beginning of the transition period, Romania has engaged in a rapid opening-up process of its economy, which has resulted, among others, in attracting significant foreign direct investment (FDI). The presence of foreign firms has grown significantly, which is a sign of increasing economic integration. FDI is a key factor in the process of economic modernization, complementing domestic sources of funding and contributing to raising productivity growth through changes in the sectoral composition of production, technology transfer and greater competition pressures. Foreign investment, bringing technology and capital creates new jobs and contributes to improving the quality of work force. In order to attract FDI, it is necessary to address the challenge of supporting the competitivity as host country.

After a shy start in the first years of transition, FDI stocks increased significantly in 1997, three times higher than in 1996, while in the following year 1998 reached the greatest value of FDI recorded in the '90. The period between 1999 and 2002 was characterized by a FDI stock diminished to about half of the figure in 1998. In 2003, the investment value increased, reaching a little over the value in 1998.

Starting 2004, Romania has become one of the most important FDI beneficiaries. If in 2000 it attracted 5% of the total FDI in Central and Eastern European (CEE) countries, during 2003 and 2005 attracted 15% of the total FDI in region. Of course these are the most important years for the great privatizations: Romtelecom (1998, 675 mill. Euro), SNP Petrom (2004, 1529 mill. euro), BCR (2005, 3750 mill. euro).

In the latest years, Romania benefited of high flows of FDI. Although FDI/capita is relatively low, reaching 35% of the average level in the neighbors from CEE, it has increased six times since 1999. In 2006, Romania occupied the third place among the New Member States (NMS), after Hungary and Poland, as this was a year in which many sectors continued the privatization, and the sectors already privatized continued to increase their capital, attracting new foreign and local investments, with effects on the structure of economy.



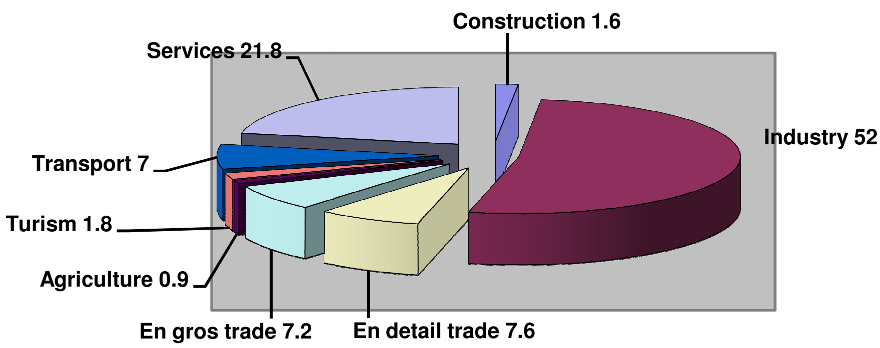
Graph 1. Evolution of FDI flows in Romania, 2000-2007 (mill. Euro)

According to data from The National Bank of Romania, in 2006, total value of FDI stock reached 30.9 bill. Euro. This represents an increase of over 9 bill. Euro, in comparison with the previous year. In this sum, 3.75 bill. come from the privatization of The Romanian Commercial Bank. FDI increased in 2006 with 41.2% in comparison with 2005. In 2007, FDI flows decreased, as a consequence of the finalization of the privatization process. Still, FDI stock which is not connected to privatization seems to have remained stable between 2006 and 2007.

Regarding Greenfield investments, these projects had a significant increase only after 2000, and especially in 2005, when were recorded 235 projects of this type (an increase with 37% in comparison with 2004)[95].

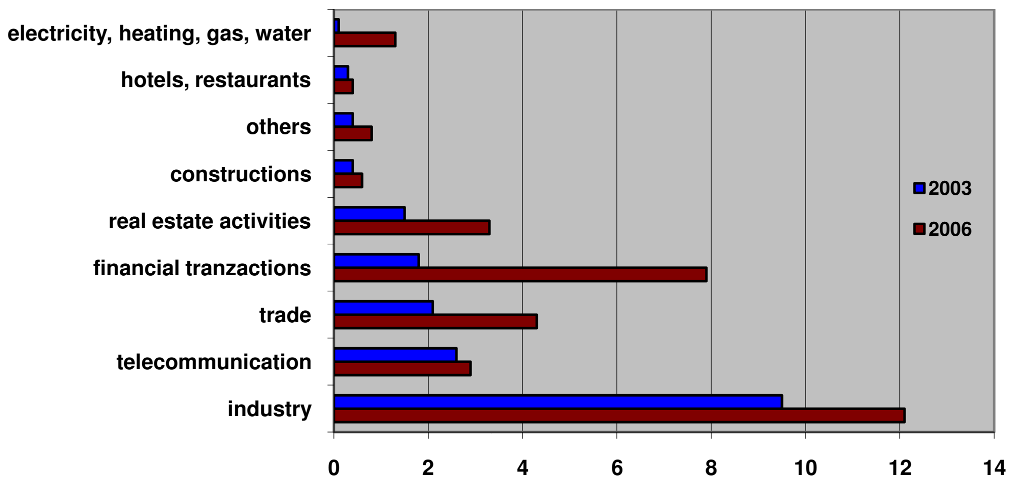
The main countries having FDI in Romania between 1991 and 2005 are: The Netherlands (15.75%), Germany (9.05%) and Italy (5.51%), over 80% coming from EU[96].

Regarding the main sectors towards which foreign investors were oriented, we can say initially they were interested in production and trade, and then they were more and more attracted by services, especially the banking and the telecommunication sectors.



Graph 2. Structure of FDI on types of activities, 1991-2005 (%)

Important changes in the sectoral composition of FDI have taken place lately. Investors' interests are shifted from advantages of low costs to sectors with higher added value. This thing is reflected in the increase of services quota in total FDI. In the same time, the manufacturing sector is also passing through changes.



[95] World Investment Report 2006, UNCTAD, United Nations, New York and Geneva, 2006, pp 263-265

[96] *Societăți cu participare străină de capital*, „Sinteză Statistică", nr.93, ian.2006, Oficiul Național al Registrului Comerțului, p 22

Graph 3. Evolution of sectoral composition of FDI flows, 2003-2006 (%)

The service sector attracted significant FDI flows in financial activities and insurances, increasing four times the FDI stock in this sector as GDP quota between 2003 and 2006. The increase in the insurance sector is a consequence of the introduction in 2007 of a voluntary pension pillar and a mandatory one in 2008. In addition, both en detail and en gross trade, real estate and business sectors doubled their GDP quota for the same period.

Still, the most important beneficiary as FDI stocks remains the manufacturing sector, which had more than one third of the total FDI in 2006. While ISD stock increased in the analyzed period, there were some relocations within the sector, as FDI in clothing sector decreased (clothing and leather sectors decreased from 47% in 1999 to 30% in 2006), while it increased in other fields with higher added value and intensive in high-skilled labor force, such as furniture, transport equipments, automobiles and IT industries. Transport equipments recorded one of the strongest FDI flows, due to qualified work force and tradition, their export quota in the total of exported manufactured goods increased from 7% in 2003 to 13% in 2006 (NMS average is 18%). In this sector the technology transfer is high. We can conclude that there are clear signs that Romania is making the transition from to sectors based on the competition of low wages to sectors with higher added value.

Foreign investors are attracted by the cheap labor force, proximity to the Euro zone, macroeconomic bases and a potential in growth of the internal market. However, the boom of the FDI determined by privatization is over. More than that, the advantage of low costs for labor is slowly disappearing, as wages are growing significantly.

Taking into account the fact that the main drivers for investments are almost gone, it is important to identify other factors to stimulate future investments with high added value. Business environment and infrastructure become more important[97], and also high skilled labor force is an essential condition for investors.

Economic reality confirms that FDI flows are oriented towards countries which practically demonstrate elements in favor of FDI, such as: a free commercial regime, a payment system at international standards, a free currency system, financial and fiscal facilities, a limited role of state in economy. Incentives may have a positive effect only if they are transparent and automatic. A climate favorable for business is preferred to facilities, so the main preoccupation must be the elimination of barriers.

UE enlargement has contributed significantly to raising Romania's attractiveness for foreign investments. Through the adoption of acquis, it has conformed to European regulations, records economic growth and has a market economy status. The transition towards ERM II has created institutional instruments for a controlled inflation and competitional pressures have strengthened monetary discipline. The geographical position, central in European space assures another advantage compared to rival emergent markets and offers advantages for investors in industries sensitive to distances, those supposing a rapid reaction to changes in consume markets, those using heavy, big or fragile products. Therefore Romania is an attractive location as an export platform, serving for new markets in EU or for those emerging at European periphery.

Other advantages for foreign investors taking into consideration Romania as a possible destination for the development of their business refer to: the dimension of the internal market – one of the biggest in CEE, rich natural resources, a small tax on profit, numerous agreements for avoiding double taxation (this is very important as most recent studies[98] consider taxation a fundamental driver for the investment decision, especially if economies in competition offer similar advantages as location), political advantages – NATO and EU membership.

Business environment plays a fundamental role in choosing a country for FDI destination. In order to support investors, many international institutions and organizations make studies to analyze economies in the world regarding the attractiveness of the business environment. According to the most recent study made by World

[97] **Demekas, G.D. et al.**, *Foreign Direct Investment in Southeastern Europe: How (and how much) can policies help?,* IMF Working Paper No 05/110, 2005

[98] **OECD**, *Corporate Taxation and Foreign Direct Investment: India's Tax Competitivness*, paper work presented at conference: Taxation Policy for accelerating investment: Domestic and Foreign, New Delphi, 13-14 Nov. 2002

Bank[99], in 2007 Romania placed itself on the 48th position out of 178 countries analyzed, a better score than the previous year (the 55th position in 2006)[100].

Among the problems negatively affecting the business environment could be mentioned the improper functioning of public administration and unstable legislation, corruption, the judiciary system. Other reforms are necessary for infrastructure, especially for modernizing the road network. There are challenges regarding work force qualification, improving the connection between education and labour market requests (due to heavy migration we face the lack of quality work force). Other factors discouraging investments refer to: negative external perception, problems with industrial and intellectual property, conflicts' settlement, socio-cultural factors (e.g. attitude towards foreigners).

Another important factor influencing FDI is the technological profile and Romania is found among countries still left behind in comparison with most EU-15 countries. This is the explanation for investors' orientation to activities requesting simple operations, which reduce the probability of technology diffusion.[101] In addition, the technology gap between local firms and multinationals means that the first can not face competitional pressures.

According to UNCTAD data[102], Romania must substantially improve its potential as host country for FDI, being placed on the worst position (17.5 points) in comparison with the other NMS (an average score of 25.3 points) and UE-15 (37.9 points).

FDI have a significant impact and are generally seen as a catalyst for economic growth and industrial restructuring. FDI complement domestic financing resources, increasing the potential for further production increases and employment creation, but they may also promote positive indirect effects (spillovers) if the presence of foreign multinationals improves the productivity performance of the domestically-owned firms they interact with (competitors, suppliers and clients) via technology transfers and enhanced competition pressure [103]. Positive spillovers of FDI are less clear and, to exploit them it is important to improve the competitivity for attracting new FDI, especially high-tech ones, and a business environment favourable for connections between domestic and foreign companies.

According to the estimations made by the United Nations [104], 22% of FDI experts and 27% of the questioned multinationals appreciated Romania as being the most attractive investing destination in south-east Europe, creating strong expectations for a positive evolution of investment flows. To conclude we could say that Romania has enough strengths to be an interesting destination for investors, but the EU member state status is not a guarantee for attracting more FDI, without continuous efforts for further reforms and the business environment improvement.

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[99] **World Bank**, *Doing Business 2008*, www.worlbank.org

[100] Calculations made on Ease of Doing Business Index, a composite index measuring 10 criteria: Starting a Business, Dealing with Licenses, Employing Workers, Registering Property, Getting Credit, Protecting Investors, Paying Taxes, Trading Across Borders, Enforcing Contracts, Closing a Business)

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