ROMANIAN INVESTMENT POOLICY ANALYSIS

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Starting with the year 2009, the European Union, as well as the rest of the world, was affected by the economic and financial crisis, and one of the effects reflected in the decrease of foreign direct investment (FDI) projects and also in the reduction of their host locations. Creating a healthy economic environment, that should be efficient for any form of international investment , represents the nowadays challenge of all market economies. This paper concentrates on analyzing our country's attractiveness from the international investor's perspective, it also focuses on the Romanian investment policy, its investment climate, as well as on identifying or valuating the strengths and opportunities offered by Romania. The advantages of the foreign direct investments are universally recognized and they basically include the expansion of the production capacity and income, job creation, technologically diffusion and economic development. Creating an appropriate economic environment, that is efficient for any form of international investments represents the nowadays challenge of all market economies. OECD member states experience, for example, outlines the advantages of a functional legal and normative climate, based on the principles of transparency and non discrimination, that are essential for attracting foreign investments. In the actual competition for attracting FDI, every state tries to offer as many incentives to the future foreign investors. The Romanian investment policy sets out incentives in a non-discriminatory and transparent way offering the investors the specific criteria. The Romanian business environment has improved significantly in recent years, driven in particular by EU accession. Major progress has been recorded in areas such as the fiscal environment, rule of law, the fight against corruption and property registration. When considering our country a possible location for the development of their businesses, the foreign investors are driven by the advantages offered for encouraging the FDI attraction, and so, they closely analyze the following aspects and advantages: geographic and market related advantages, the Romanian resources (natural, material, human resources), economic, politic and social drivers and also international status, regarding the diplomatic bilateral agreements.

Key words: Foreign direct investment (FDI), investment policy, incentives, attracting FDI, economic development, economic growth, investment climate

The article's JEL code: F21, F23, F55

Introduction

The advantages of foreign direct investments (FDI) are universally recognized and they basiclly include the expansion of the production capacity and income, job creation, technologically diffusion and economic development. Creating an appropriate economic environment, that is efficient for any form of international investments represents the nowadays challenge of all market economies. OECD member states experience, for example, outlines the advantages of a functional legal and normative climate, based on the principles of transparency and non discrimination, that are essential for attracting foreign investments.

In my opinion, FDI can be easily attracted when the investors understand very well the environment in which they will operate, that is why for an investment policy to be efficient, it is necessary to be focused on the transparent legal environment based on the principle of stability and predictability, and also on actions and services concentrated on promoting the investments.

The principle of national treatment refers to the fact that the governments of FDI host countries' must treat the foreign investors as well as the national investors. Practically, the majority of

countries still maintain some restrictions regarding the foreign investments, in order to protect some industries considered strategic.

Lately, Romania registered an important progress in including the national treatment in its investment policy, eliminating a great part of its restrictions. In Romania, the forms of national treatment restrictions are the following:

- a 49% foreign ownership limitation in industries and sectors related to arms manufacturing, trading and production
- a limitation on foreign ownership of agricultural land
- restrictions on the purchase of real estate in areas deemed sensitive, *e.g.* forests, border zones, national parks and historical areas

The Romanian business environment has improved significantly in recent years, driven in particular by EU accession. Major progress has been recorded in areas such as the fiscal environment, rule of law, the fight against corruption and property registration. Harmonisation of the fiscal system with EU legislation and norms has brought about a modern and predictable tax system. Moreover, lower corporate and personal tax rates have contributed to improving the fiscal environment. Strengthening the rule of law has also been a priority. New legislation was passed in 2006 to improve transparency, and a National Integrity Agency was established in 2007. Public awareness campaigns to fight corruption in public administration and the judiciary have been carried out over the past two years (FIC, 2009). Romania is also member of WTO and applies the rules of TRIMS and GATS and it is the only country in the South Eastern Europe that signed OECD Declaration on International Investments and Transnational Corporations.

The transfer of capital, the repatriations of profits and liquidities is an essential determinant of FDI, contributing to any state's capacity of attraction and absorption of FDI. In Romania, the capital inflow from FDI is free and without delays.

In the actual competition for attracting FDI, every state tries to offer as many incentives to the future foreign investors. OECD defines the FDI incentives as "measures ment to influence the size, location and industry of a FDI project, by modifying its cost or its associated risks, throughout several conditions that are not available for the national investors".

The incentives offered to the foreign investors may take the form of fiscal, financial and normative incentives. Romania offers the following incentives to the international investors:

-Tax exemptions: total or partial reductions on the earnings tax for a certain period of time;
-Grants: based on the number of jobs created;
-Special zones: access to industrial parks;
-Free trade areas

The Romanian investment policy sets out incentives in a non-discriminatory and transparent way offering the investors the specific criteria.

The performance requirements represent certain conditions imposed by the host countries to foreign investors. According to an OECD study released in 2010, Romania meets all this requirements, due to its WTO membership and its status of TRIMS Agreement signatory.

Secure and transferrable rights to rural, urban and other types of land and forms of property are a prerequisite for a healthy investment environment. Well defined property rights represent determinants that attract and maintain FDI.

After our country's accession to the EU, foreign investors are allowed to own residential, industrial and agricultural land.

Intellectual property rights give investors an incentive to locate their businesses in Romania, when referring to the development of new products and services. It also gives investors the needed confidence to expand their production throughout Joint Ventures and licensing agreements. Due to its EU and WTO membership, Romania made an important progress in its efforts of defining the intellectual property framework.

The compensation of expropriation is another important incentive in the process of attracting FDI, but in certain situations the governments may legitimaly need to enter in possession of certain private property, like in some cases of transport and energy infrastructure development projects. In Romania, the compensation of expropriation or the nationalization process takes place under constitutional provisions, that are different from Romanian FDI legislation.

Economic and investment climate in Romania

According to the Europe's Investment Attractiveness Report issued in 2010 by Ernst&Young, the foreign investors interest for Europe and also Romania reduced significantly. Compared to the year 2008, in 2009 Europe registered a 11% decrease in the number of FDI projects and a 16% decrease in the number of jobs created, also being confronted to serious difficulties due to investors lack of capital and the tightening of financing conditions.

In 2009, the number of FDI projects almost halved and the number of jobs created reduced with almost 44%. According to the same Ernst&Young study, Romania registered a 48% decrease of the number of FDI projects and a 44% in the number of jobs created, compared with the previous year.

In 2009, Romania attracted 75 FDI projects, this number representing 2% of the total number of projects attracted in Europe, generating 6.384 new jobs or 5% of the total number of jobs created.

In 2009, Romania classified the seventh in Europe according to the number of jobs created, and eleventh according to the FDI share in the total FDI.

Despite the difficult period that challenges our country from this point of view, Romania is still considered an attractive destination for industrial FDI projects, representing 7% of the total number of FDI projects in Europe.

Our country's accession to the EU, materialized in a period of economic growth, occupying the second position in South Eastern Europe, considering the value of GDP per capita of 12600 USD. According to the information presented by the IMF (in 2009), Romania recorded a medium annual GDP growth of 6% in the period 2003 – 2007, increasing in 2008 at 7.1%. This increase was due to the strong internal demand and investments. In 2009, our country's economic growth slowed down considerably, and according to the European Commissions' forecasts, it decreased significantly with 8%. Romanian government negotiated a 12.3 billion USD Stand By Agreement with the IMF and the crisis generated by the measures taken strongly affected the financial sector, most of the banks canceling their development plans and restricting their regulatory framework.

Our country was considered an attractive location for the foreign investors due to its low labor costs and taxes, also to its developing market and its accession to the EU. In 2008, the FDI inflows represented 9.1 billion USD, in other words 6.7% of GDP (UNCTAD 2009). The main sectors that benefited from FDI were constructions, real estate, industrial sector, financial services and insurance (FIC 2009).

Romanian business environment improved considerably with our country's EU accession, occupying the 55th position in the top published by the World Bank in 2010, being the second in the South Eastern Europe economies.

The fields the improved the most were the financial sector, the rule of law, the fight against the corruption

and the intellectual property. The fiscal system harmonization with the EU legislation and norms materialized with a new, modern and predictable taxation system. But a slow - down in the reform process could also be noticed after Romania joined the EU in January 2007, some fields still needing important changes, like the corporate governance for example.

As regarding the investments promotion, Romania is in process of revising the Foreign Investments Promotion Agency. Romanian should also increase the quality of the services offered to the foreign investors in the pre and post – entrance phase, regarding: the consultancy offered in order to business registration, licenses and work permits. It could also consider the

implementation of a certain program that should facilitate the commercial connections between the foreign investors and the local companies.

When considering Romania a possible location for their business development, the foreign investors look closely to the advantages offered by our country. In this context, according to the Romanian Agency for Foreign Investments there were identified certain advantages offered in order to attract FDI.

From a *geographical and market perspective* Romania is one of the largest markets in Central and Eastern Europe (ranking 7th , with over 21 million inhabitants); EU unique market gateway (access to approximately 500 million consumers) and is also an attractive location: situated at the turning point between EU, the Balkans and CIS countries, our country is crossed by three important pan-European transportation corridors: corridor no. IV linking Western and Eastern Europe, corridor no. IX connecting Northern and Southern Europe and no. VII – Danube River, facilitating inland water transportation, at the same time connecting the Romanian Port of Constanta (the biggest Port to the Black Sea) to Northern Europe, through the Rhine.

From the *resources perspective* Romania owns highly skilled labor force at competitive prices (solid knowledge in foreign languages, technology, IT, engineering, etc); rich natural resources, including surface and underground waters, fertile agricultural land, oil and gas; high potential for tourism.

From the *international perspective*, foreign investors have the following advantages: EU, WTO and NATO membership, member of the UN and other international organizations, like: OSCE, Council of Europe and International Organization of La Francophonie.

From the *economic perspective*, Romania offers the following incentives: Tax exemption of the reinvested profit; state aid schemes for encouraging investors to take upon Romania; increasing interest on behalf of Foreign Investors – leader destination for FDI in the region (2010 A.T. Kearney Foreign Direct Investment Confidence index) and also sound fiscal policy (16% flat tax).

From the *legal perspective*, the foreign investors have similar legal provisions as in the EU (Acquis Communautaire implementation); fiscal policy regulated by the Fiscal Code.

Other advantages are the continuously improving infrastructure (commitment to improve the highway infrastructure to EU standards); well-developed networks of mobile telecommunications in GSM systems; developed industrial infrastructure, including oil and petrochemicals; extensive maritime and river navigation facilities.

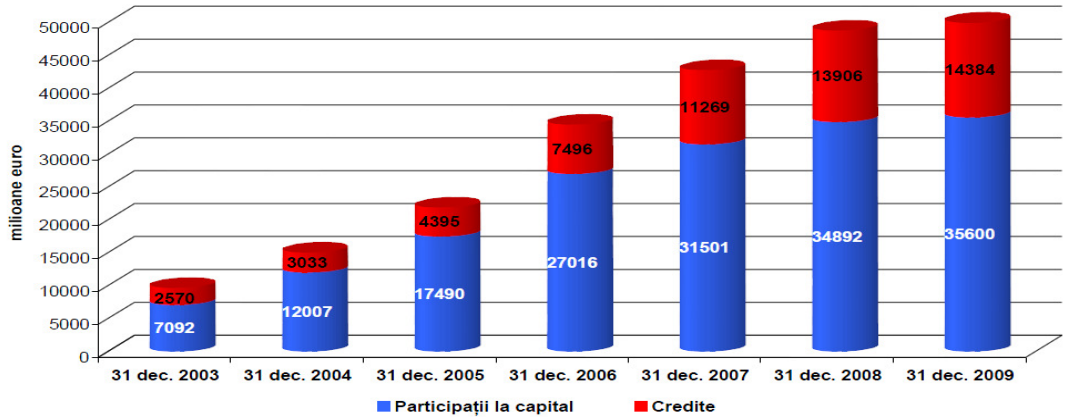
FDI in Romania

The net FDI inflows in Romania in 2009 reached *3488 million euro* and their structure is the following*: foreign investors net participations* to the FDI social capital registered *1729 million euro* (49.6% of the net FDI flow) and the *net credit of Joint Ventures* coming from the foreign investors summed *1759 million euro* (50.4% of the net FDI flow).

In 2009, the *FDI stock*s summed up *49984 million euro,* 2.4% more than in 2008.

The social capital participations (including the reinvested profit) of FDI registered *35600 million euro* (71.2% of the final stock of FDI), 2% more than in the previous year and the *total net credit* of FDI registered reached *14384 million euro,* representing 28,8% of the total FDI stock and also presenting a 3.4% increase compared with the previous year.

Figure 1:FDI flows analysis in Romania during 2003 – 2009

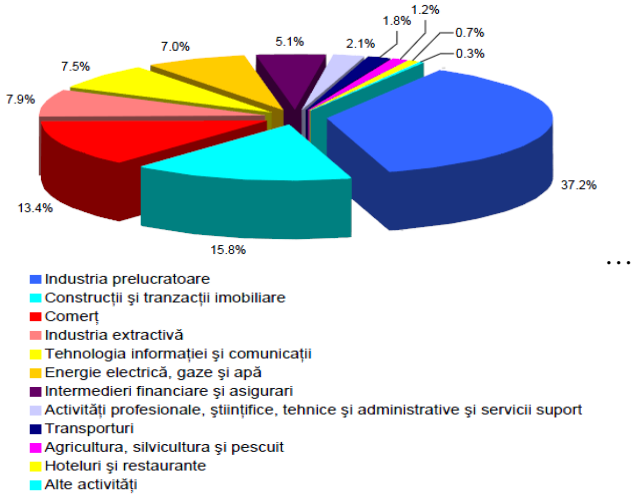


Source: Information published in the NBR FDI Report, 2009, available at link http://www.bnr.ro/Investitiile-straine-directe-%28ISD%29-in-Romania-3174.aspx

From the investors orientation perspective, FDI were located in the *manufacturing industry* (31.1% of the total) and the best represented sectors being petrol, chemicals, plastic masses (6.3% of the total), metallurgy (5.2%), transport industry (4.7%), food, beverages and tabaco industry (4.1%) and cement, glass and ceramics (3.3%). The textile and confection field (1.4%) registered value is less than expected.

Expect the industry field, other sectors that attracted important FDI are *financial services and insurance* representing 19% of the total FDI inflows, *constructions and real estate transactions* (12.9%), *trade and retail* (12.3%) *ITC* (6.5%)

Figure 2: FDI stock structure in Romania - 2009

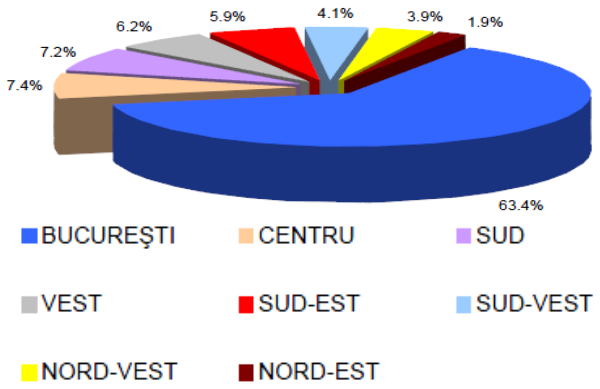


Source: published in the NBR FDI Report, 2009, available at link *http://www.bnr.ro/Investitiile-straine-directe-%28ISD%29-in-Romania-3174.aspx*

From a territorial perspective the orientation of FDI is clearly heading to Bucharest – Ilfov development region (63,4%), but other FDI host regions are: the Centre Region (7,4%), South Region (7,2%), West Region (6,2%) and South – East Region (5,9%).

The North East Region is the least attractive one for the foreign investors, registering only 1.9% of the total amount of FDI.

Figure 3: FDI structure on development regions - 2009



Source: published in the NBR FDI Report, 2009, available at link http://www.bnr.ro/Investitiile-straine-directe-%28ISD%29-in-Romania-3174.aspx

Romania's competitive advantage compared to the other countries in the region is not represented by the low cost labour force, in my opinion the market dimension is the driver that counts. After Poland, Romania has the most important consumption potential, hosting a bigger population then Hungary and Bulgaria together.

In conclusion, if Romania doesn't want to lose its few foreign investments attracted until now (less then Hungary and Poland in 2008) the national authorities should focus its actions on stimulating the consumption rather than the excessive fiscal system.

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