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Foreign direct investment vs domestic investment across the European Union. Case study: Romania

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Abstract. The paper deals with the idea that investment process is important not only for the economic growth, but for the global integration. There is a powerful connection between FDI and domestic investments. As a result, the analysis is focused on FDI flows in EU28 and Euro area. The comparative analysis is followed by regression, in order to point out the disparities between Member States and their trend. The average value of inward and outward FDI flows is analysed using FDI intensity. A distinct part of the paper is focused on domestic investment process and analyses total investment, investment in construction and investment in equipment. The analysis is supported by the latest official statistical data, pertinent diagrams and tables. The main conclusion of the paper is that the economic crisis in Europe led to a decrease in FDI and domestic investment flows.

Keywords: FDI technology spillovers; FDI inflows; FDI outflows; FDI intensity; investment environment.

1 Introduction

The European Union is not able to declare the end of the economic crisis even in 2015. The great socio-economic disparities between the Member States and regions are too great to be ignored. The recent Greek crisis and the emigrants' crisis built new challenges for the European Union, as well.

The classical approach to the EU as a major global target for the foreign direct investment seems to be changed. The crisis and the economic instability in some Member States forced investors to search for new investment locations.

On the other hand, foreign direct investments are very important for the European economy. This is why an analysis of the post-crisis investment's evolution and their trend becomes important.

2 Literature review

The role of FDI and their location across the world are the main targets for the multinational enterprises (Blonigen Bruce A., 2005).

Some specialists point out the positive impact of FDI on host countries, even that domestic R&D spending as a percentage of GDP is the main determinant of FDI technology spillovers. A study, which covered 1966-2000, concluded that government policies encouraging R&D activities may significantly increase the magnitude of technology spillovers from FDI (Elmawazini K., 2010).

In order to obtain maximum positive effects, is necessary a good connection between foreign direct investments (FDI), financial markets and economic growth. A better domestic financial system can

exploit FDI more efficiently and obtain more economic growth (Alfaroa L., Chandab A., Kalemli-Ozcanc S.,Sayekd S., 2004).

An interesting aspect of FDI analysing is their impact on economic growth in developing countries. A dedicated study, for example, indicates that GDP, inflation and exchange rate are affected to the extent of 46.5% by FDI (Umeora C.E., 2013).

A similarly approach is realised in order to use the Granger Causality Test in order to study the relationship between FDI and Economic Growth. A very interesting conclusion of the analysis in this paper is that that school enrolment can increase the GDP and indirectly the FDI (Lamine K.M. & Yang D., 2010).

In Romania, the FDI analysis is large enough. The connection between FDI and the economic growth is presented in order to point out the significant impact of the capital flows on host country. Moreover, the effects of FDI are transmitted using financial markets, host country absorptive capacity, human and technological capital (Carp L., 2012).

The FDI in Romania is the main target of a scientific paper focused on their role in the economic growth (Mistzal P., 2011).

Finally, other Romanian specialists focused on modelling the relationship between FDI and economic growth using a neoclassical model based on Cobb-Douglas production functions (Roman M.D.& Pădureanu A., 2012).

European Commission, using Eurostat, realises researches connected to FDI. The latest one covers 2004-2012 and concludes that the Member States which adhered starting to 2004 attract more FDI than they invest abroad (Eurostat, 2015).

3 FDI's trend across the European Union

According to the latest European Commission's official forecasting document, the European moderate demand led to weak investment. As a result, the capacity utilization achieved low levels and the economic and policy uncertainty continued. Moreover, some Member States faced to funding constraints (European Commission, 2015).

As a general conclusion, EU28 is a net investor relative to the rest of the world. The gap between inward and outward FDI grew from 4% of GDP in 2004, to 10% in 2012.

On the other hand, FDI flows have declined in 2012 by 14% from 2011. The leading investing economy is USA, while China became the first FDI destination in 2012. Investment to and from the European Union declined by 25% (OECD, 2013).

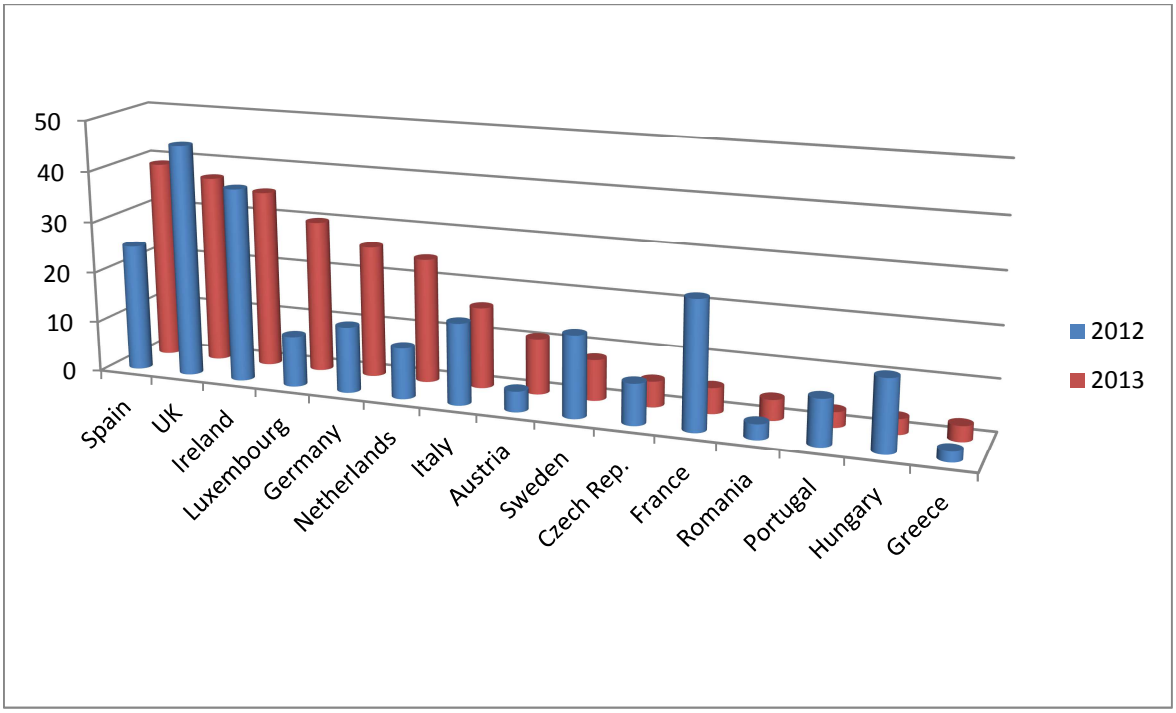
Table 1 FDI flows (% of GDP)

	Inflows					Outflows				
	2008	2009	2010	2011	2012	2008	2009	2010	2011	2012
USA	2.2	1.1	1.4	1.6	1.1	2.3	2.1	2.3	2.8	2.2
EU	3.2	2.4	2.4	2.7	2.0	5.8	2.6	3.4	3.4	2.5
China	3.9	2.3	3.1	3.1	3.1	1.2	0.9	1.0	0.6	0.8

Source: OECD International Direct Investment database, IMF

The FDI negative trend in the EU continued and EU28 was not able to achieve again its leading position as the world's most important recipient of FDI. As a result, the global FDI inflows in the EU decreased from 50% in the early 2000s, to less than 20%. On the other hand, more than 60% of total inward FDI flows into European countries are intra - EU investments.

The top FDI destinations in the EU were Spain, UK and Ireland in 2013. These three Member States covered 15% of the total 240 billion Euros inflows. More FDI inflows attracted Ireland, Luxembourg, Germany, Netherlands, Italy and Greece, as well. On the other hand, France, Sweden, Portugal and Hungary faced to less FDI in 2013 than in 2012. Finland, Belgium and Poland had negative net inflows in 2013 (Deutsche Bank, 2014).



Source: personal contribution using UNCTAD database

Figure 1 Largest EU FDI recipients in 2013 (bn USD)

According to Figure 1, the FDI trend in the EU is analyzed in the context of the economic globalization.

Across the EU Member States, the FDI flows led to great disparities. In order to highlight these disparities, EU direct investments are analyzed using FDI intensity as pertinent indicator. FDI intensity quantifies the average value of inward and outward FDI flows (see Table 2).

Table 2 FDI intensity (% of GDP)

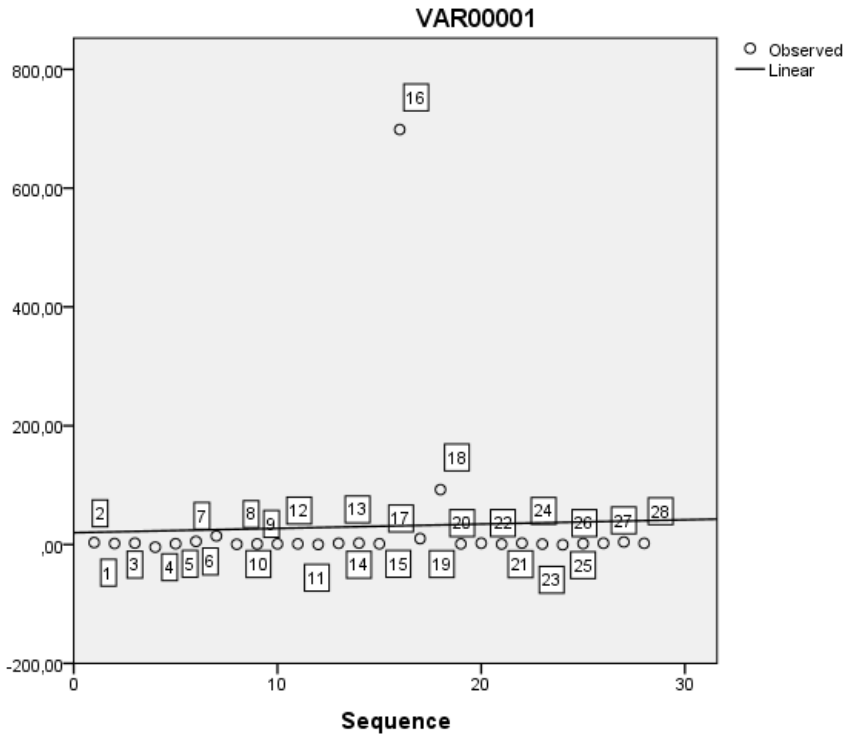
	2008	2009	2010	2011	2012
EU28	2.2	2.6	2.1	3.5	2.4
Belgium	40.9	1.9	5.3	9.8	3.3
Bulgaria	10.2	3.4	1.8	1.9	1.8

	2008	2009	2010	2011	2012
Czech Rep.	2.4	1.0	1.8	0.5	2.5
Denmark	2.2	1.7	-1.9	3.9	-4.3
Germany	1.1	1.4	2.7	1.9	1.4
Estonia	6.0	8.7	4.6	-2.5	5.4
Ireland	0.5	11.6	15.6	5.0	14.4
Greece	1.0	0.7	0.3	0.5	0.5
Spain	4.8	0.8	2.8	2.2	0.9
France	3.9	2.5	1.9	1.6	1.0
Croatia	3.6	3.7	0.2	1.2	1.1
Italy	1.2	1.0	1.0	2.0	0.2
Cyprus	8.2	8.2	3.1	9.2	2.1
Latvia	2.2	0.1	0.8	2.7	2.3
Lithuania	2.4	0.2	1.1	1.7	1.3
Luxembourg	220.5	436.4	410.7	677.8	698.6
Hungary	2.8	1.5	1.3	3.8	10.0
Malta	8.0	3.2	6.2	1.4	92.5
Netherlands	4.2	4.6	3.9	3.7	1.0
Austria	4.4	2.5	1.4	3.9	2.2
Poland	1.8	2.2	2.2	2.8	0.7
Portugal	1.5	0.8	-1.1	5.5	2.3
Romania	3.5	1.4	0.9	0.7	0.8
Slovenia	3.1	-0.4	0.2	1.1	-0.4
Slovakia	2.8	0.5	1.6	2.2	1.6
Finland	1.5	1.3	3.5	1.4	2.2
Sweden	6.9	4.5	2.2	4.0	4.3
UK	5.1	2.6	1.9	2.9	2.0

Source: Eurostat, 16-07-2015.

According to FDI intensity, if it increases over time, then the Member State becomes more integrated with the international economy. Only Greece, Luxembourg, Hungary and Sweden succeeded to achieve greater rates during the next three years (2010-2012) and improved their integration with the international economy.

On the other hand, disparities between the Member States increased in 2012 (see Figure 2).



1. Belgium; 2. Bulgaria; 3. Czech Republic; 4. Denmark; 5. Germany; 6. Estonia; 7. Ireland; 8. Greece; 9. Spain; 10. France; 11. Croatia; 12. Italy; 13. Cyprus; 14. Latvia; 15. Lithuania; 16. Luxembourg; 17. Hungary; 18. Malta; 19. Netherlands; 20. Austria; 21. Poland; 22. Portugal; 23. Romania; 24. Slovenia; 25. Slovakia; 26. Finland; 27. Sweden; 28. UK.

Source: personal contribution using IBM-SPSS software

Figure 2 FDI intensity's disparities in 2012 (% of GDP)

4 Domestic investment's trend across the European Union

The increase in investment across the EU28 is supported by exports and private consumption recovery. On the other hand, the balance-sheet repairing and economic uncertainty persisting have negative impact on investment's evolution (European Commission, 2014).

As a result, total investment grew by 2.5% in EU28 and 1.1% in Euro area in 2014. In November 2014, the Investment Plan for Europe was implemented, in order to achieve 315 billion Euro of new investment within three years (European Commission b, 2014).

This Plan tries to stimulate investment in order to increase their contribution to change in GDP. The investment contribution to GDP is different for EU28 and Euro area (see Table 3).

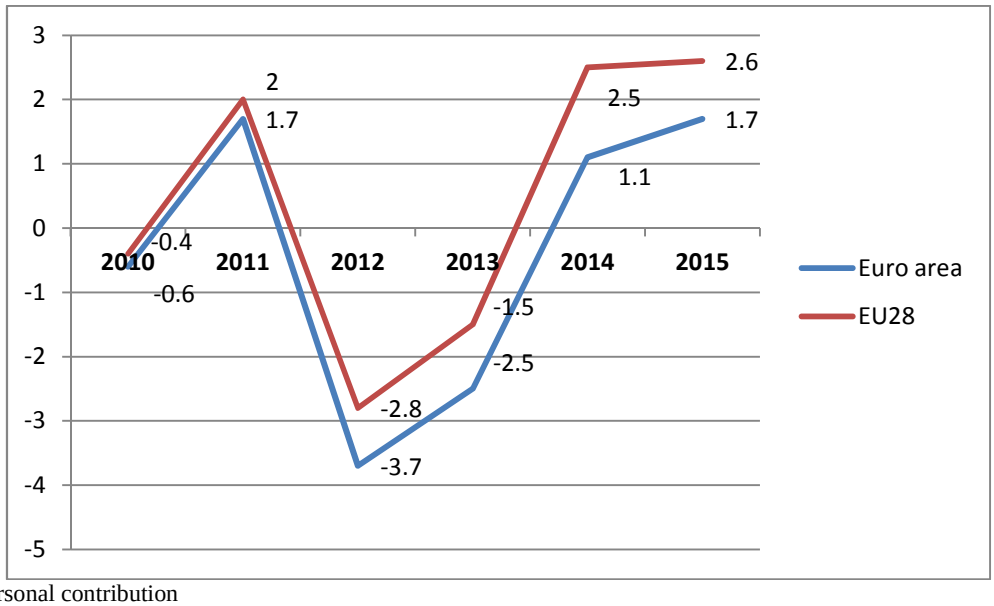
Table 3 Investment contribution in GDP (%)

	2009	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
EU	-2.7	0.0	0.4	-0.6	-0.3	0.5	0.5
Euro area	-2.6	-0.1	0.3	-0.8	-0.5	0.2	0.3

Source: European Commission, 2015, pp. 22-23.

Basically, the latest two years (2014-2015) brought positive investment contribution in GDP in the EU28 and Euro area.

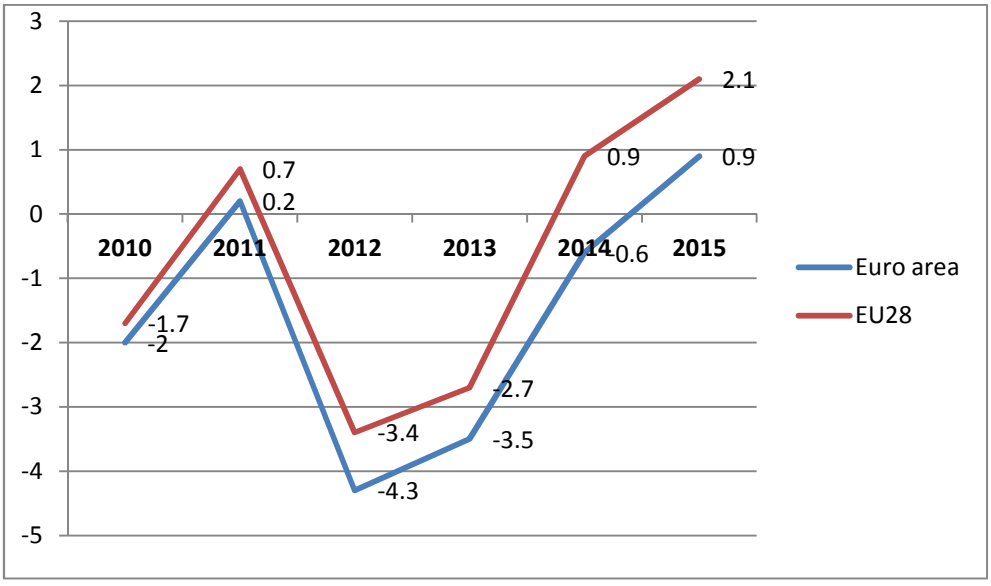
On the other hand, there are great differences between the trends of total investment, investment in construction and in equipment between EU28 and Euro area (see Figure 3).



Source: personal contribution

Figure 3 Total investment volume (% change on preceding year)

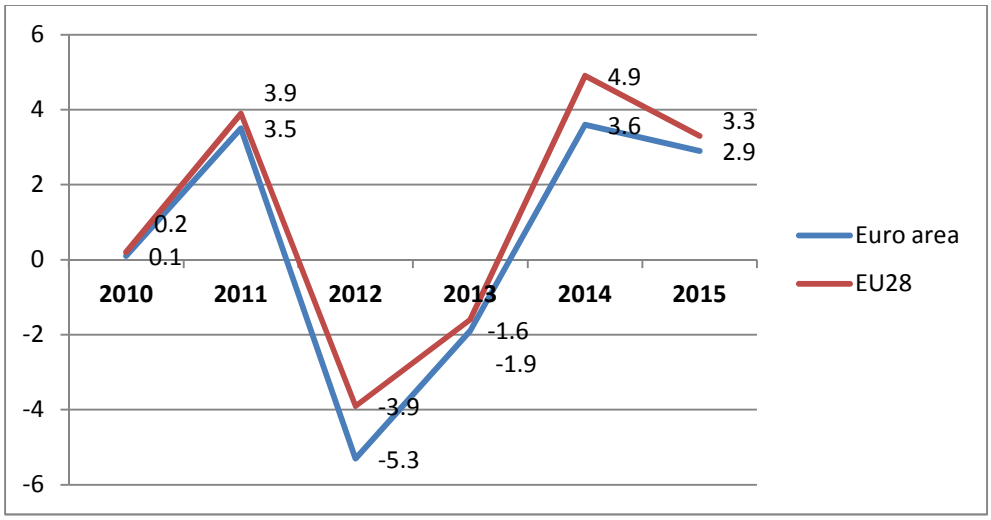
EU28 achieved better investment impact than Euro area during 2010-2015. The short term forecasts talk about a greater rate in EU28 (4.2%) than in Euro area (4.0%) even in 2016. According to investment in construction, the evolutions of EU28 and Euro area are presented in Figure 4.



Source: personal contribution

Figure 4 Investment in construction volume (% change on preceding year)

The construction sector seems to be more affected by the crisis and uncertainty. In this context, EU28 achieved again better performance than Euro area. The investment in construction growth rate will be 2.7% in Euro area and 3.2% in EU28 in 2016.



Source: personal contribution

Figure 5 Investment in equipment volume (% change on preceding year)

The most important component of investment is that focused on equipment. The official statistical data lead to the same trend with both above (see Figure 5).

The positive trend during 2012-2014, is followed by a new decrease in 2015. On the other hand, the forecasts are optimistic for 2016: 6.0% in Euro area and 5.7% in EU28.

5 Investment process in Romania

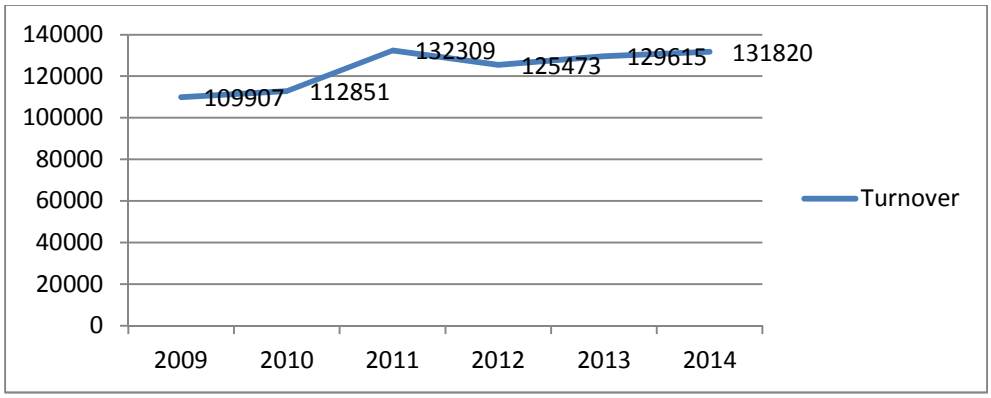
The net FDI flux in Romania was 2421 million Euros in 2014. At the end of 2014, the structure of FDI was:

Table 4 FDI structure (%)

Economic activity	% of total FDI
Industry	48.7
Research, training, technical and administrative services	5.1
Agriculture, forestry and fishing	2.5
Trade	11.7
Construction and real estate	9.8
Hotels and restaurants	0.9
Financial intermediation and insurance	13.0
Information technology and communication	6.0
Transports	1.7
Other	0.6

Source: National Bank of Romania, 2015.

The main foreign investors in Romania are: Netherlands (23.6% of total FDI), Austria (16.1%), Germany (12.4%), Cyprus (7.1%) and France (6.8%). Almost all foreign investors in Romania are Member States, excepting Switzerland (3.6%), USA (1.8%) and Turkey (0.8%).

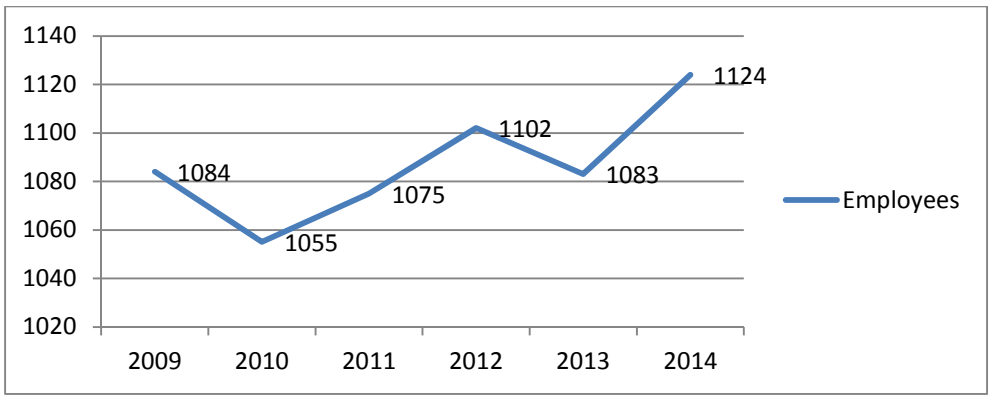


Source: personal contribution

Figure 6 The turnover in the FDI companies from Romania (mill. Euros)

The turnover and the employees in the FDI companies from Romania have oscillating evolutions (see Figure 6 and Figure 7).

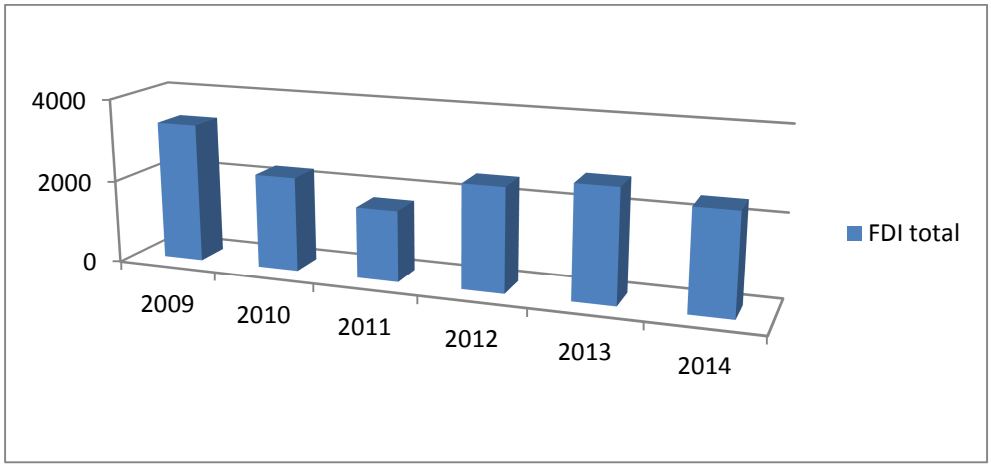
According to the above figure, the turnover increased constant during 2012-2014, but its peak was achieved in 2011.



Source: personal contribution

Figure 7 Employees in the FDI companies from Romania (thousand persons)

The peak in hiring employees was achieved in 2014, after a decrease in 2013. Basically, more than one million persons work in these companies. This is the result of the FDI impact on Romania economy (see Figure 8).

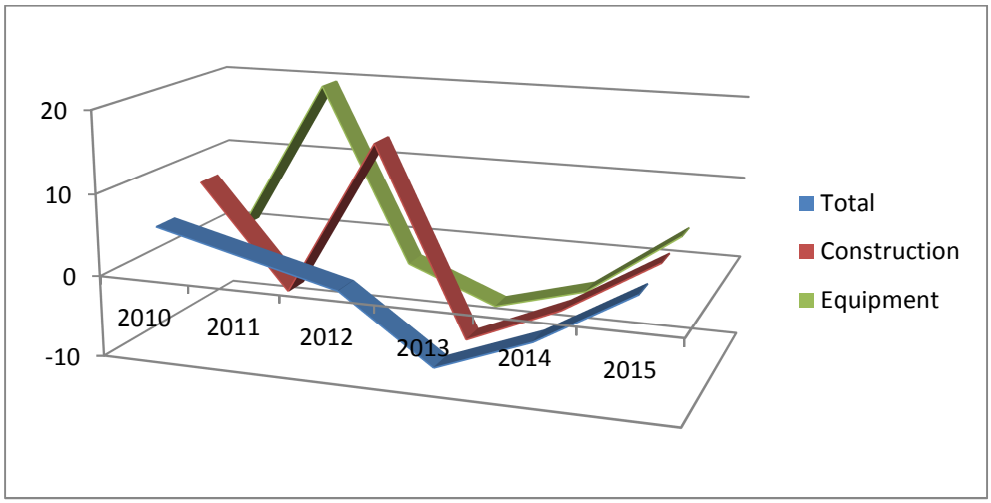


Source: personal contribution

Figure 8 FDI in Romania (mill. Euros)

Unfortunately, the FDI peak in 2009 (3357 mill. Euros) wasn't achieved again. Moreover, the FDI level decreased in 2014 compared to 2013.

The FDI trend in Romania has to be connected to domestic investment. The total, in construction and in equipment domestic investment's evolutions are presented in Figure 9.



Source: personal contribution

Figure 8 Domestic investments in Romania (% change on preceding year)

According to Figure 8, a positive evolution started in 2013 for total, in construction and in equipment domestic investments.

The elements which supported this FDI and domestic investment evolutions were analysed by the European Commission, which point out at least 10 weaknesses of the Romanian investment environment. According to this analysis Romania has to focus on an efficient public administration and on corruption reducing within it.

6 Conclusion

In the present global economy environment, FDI have a very important impact. The economic crisis is not at the end and its negative effects are still operating even in Member States. As a result, EU lost its first rank as recipient of FDI.

The FDI flows differ a lot from a Member State to another, according to their economic development environment. These disparities led to the EU global integration degree decreasing.

The worst situation of the FDI in some Member States is followed by low domestic investment flows.

Romania faces to great problems related to FDI. There are slippages in justice, administrative and regulatory barriers and high corruption across public administration.

Negative impacts on FDI have fraud and corruption in the procurement processes. On the other hand, the taxation lack of predictability affects the investment decisions in Romania.

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