FDI Role in the Development of the Romanian Economy

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Abstract: This paper analyzes the foreign direct investments on the Romanian economy by analyzing their impact on the capital investments, balance of capital, budgetary incomes and workforce. FDI have generated significant effects at a macroeconomic level reflected on productivity, efficiency and competitiveness of the activities that have enjoyed large foreign capital inflows. In this respect, carried out analyses allow the emphasizing of several favorable and unfavorable changes associated to foreign direct investments.

Keywords: Foreign direct investments (FDI); capital investments; balance of payments

JEL Classification: G01; G32; F36

1. FDI Impact on Capital Investments

One of the ways foreign direct investments indirectly influence the economic growth is the forming of native capital, as FDI have an multiplying effect on internal investments.

The quantitative dimension of the capital contribution of FDI inflows is showed by the percentage rate between the received FDI flows and the gross forming of the fixed capital. Foreign investments supplement the internal capital when it is made „on an empty place”, leading to the development of new activities or when changing the ownership form (privatisation or company take-overs) if the so purchased company had been loosed or if, by making the foreign investment, its performance improves. It is clear that, from this point of view, the impact of foreign capital inflow is stronger that greenfield investments

Through training effects, FDIs have encouraged native investments, whom dynamics had been superior comparing to the one of foreign capital flows, indirectly contributing to the development of productive activities, and mainly of those set upstream or downstream compared to the scope of activity of the foreign subsidiary.(I. Lupasc, 2007) Another positive effect of foreign capital inflows is the bringing more internal resources, leading to the decreasing of the deficit between

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internal economies and the investments requisite, and consequently, to the growth of gross forming of fixed capital. Initially, FDI flows have registered relative high levels and have been mostly pointed towards the privatisation process, which has minimized the positive impact of the foreign capital inflows consisting of speeding up the assets purchase. Subsequently, a gradual growth of attracted FDI is registered, concomitant to a slight change in their structure favourable to greenfield investments, so that the impact of foreign capital inflows on gross fixed capital formation, ranging between 23 and almost 32% (Ivan, Iacovoiu, Buruiana, 2008) due to, from our perspective, both the concerning of foreign investors about the activity modernization and the growing competitively of the made products in order to face the competition on the Single Market, as well as the intensification of foreign greenfield investments regarding the position strengthening on the regional market, within the context of Romanian integration in the European Union. Thus, the impact of FDI flows on capital investments is concretized in positive effects represented by supplementation of internal capital used for assets acquisition as well as by the stimulation of local investments, with clear favourable influences, both direct and indirect, on economic growth.

2. FDI Impact on the Balance of Payments

The effects of foreign direct investments on the balance of payment are numerous and sometimes contradictory, being defined by a series of factors, of which the most important ones are: the type of investment, the economic efficiency, the activity field, resources access, cost of classical transactions and the intervention of the host country.

The analysis of the FDI impact on the balance of payments must take into consideration both the commercial flows (balance of trade) and the "possible significant capital outflows or other investors' possible flows defalcation" (Ioan, 1998). Within this context, the best example is the case of the Romanian wire telephony company Romtelecom, where the foreign investor was insured of the market monopoly for 5 years (1998-2003), when the tariffs had experienced a significant growth. These increased profits gained as a result of the use of anti-competitive methods can be turned into capital outflows, as excessive wages of the expatriated ones and high royalty fees, with a negative influence on the balance of payments. In the case of the countries in transition to market economy, this kind of situations is not unique, if we consider the FDI focusing on the oligopoly market.

Another issue of the analysis of FDI impact is the one of the financing methods, which influences in a direct manner the level of the external private debt. The negative effects on the balance of payment show up in the case of foreign companies borrowing from abroad and subsequently focusing on a quick recovery of the investment by using fiscal circumvention methods (high transfer price or royalty fees).

Another aspect of the analysis of FDI impact on the balance of payments regards the time tracing of the effects generated by investment projects as described: in the first phase (making the investment), the capital inflows are registered in the financial account, as a mean of balancing the balance of payments by financing the current account deficit; in the second phase (the investment implementation), due to the massive imports made by foreign companies (equipment, machinery, raw materials) there is a negative effect on the balance of trade.

In the third phase (maturity of investment), the effects on the balance of payment and trade respectively are diverse. The positive effects on the current account occur when gained profits are reinvested in the host country, and the capital outflows such as interest rates, royalty fees and the ones generated by the administrative transfer prices system are not significant. Therefore, there are many channels by which foreign direct investments can positively or negatively afflict the external balance of payments of the receiving country.

The quantitative and qualitative impact of foreign direct investments on the balance of trade is negative, due both to the highly accentuated dynamics of the imports made by the foreign companies compared to their exports, as well as a result of the fact that high added value goods have been frequently imported and low processing goods have been mostly exported. From our point of view, this unfavorable evolution is the main result of several clauses regarding the implementation of foreign investments, the preponderant guidance towards trading activities and the lack of local capacities needed for the activation of the comparative advantages through FDIs. FDI have been a significant source of financing the current account deficit, especially from 1997, when higher foreign capital flows were received. The carried out analyses have also shown that as a economic whole, foreign companies "take out less than they fill in", the net financial effect (as the difference between capital inflows and outflows) is emphasized as the FDI inflows increase. Within this context, we argue that significant foreign capital inflows consisting mainly of shares and reinvested profit against external loans could significantly tend to the balancing of the external balance of payments by the decrease in the current account deficit.

3. FDI Impact on Budgetary Expenditures and Incomes

Another aggregate effect of foreign direct investments is the one on budget, an impact that can gather way as positive as well as negative contributions. Essentially, experts assume that in the first phase, the impact on the budget is a negative one, as subsequently, once with the development of activities and the creation of new workplaces, the impact becomes positive.

Hence, as in the case of the other aggregate effects, the net effect of foreign direct investments on the budget is hard to quantify, depending to a great extent on the existing actual conditions in the host country and, especially, on the applied government policies.

The positive and negative contributions to the budget are, as described below:

Negative contributions

The initial phase (of the investment deployment)

- The decrease in the budgetary incomes as the result of the fiscal facilities granted to the foreign investors (the policy of financial incentives);
- Additional budgetary expenditures of social nature, due to the growth of unemployment as the result of privatization and reorganization of state owned companies.

The subsequent phase (maturity of the investment)

- They can lower the fees and taxes paid to the host state by using the transfer prices mechanism and other mechanisms.

Positive contributions (only in the maturity phase)

- Additional incomes for the national budget consisting in taxes and fees paid by new contributors (employees and economic agents).

Going forward, we propose an analysis on the evolution of the budgetary balance in Romania within the context of being part of the Central and Eastern European countries, classified depending on the degree of FDI involvement in the economy, with the object of emphasizing the correlation between the two variables. In this respect, we will follow the data regarding the budgetary surplus/deficit expressed as GDP percentage between 2000 and 2007 (table nr.1).

Table 1. Evolution of the budgetary balance between 2000 and 2007 (GDP percentage)

	2000	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Evolution of the budgetary balance	-4,4	-3,5	-2,0	-1,5	-1,2	-1,2	-2,2	-2,5

Source: Statistical EUROSTAT reports

The data above emphasizes, on a divergent trend, a decrease in the budgetary deficit in Romania in 2007 comparing to the year 2000. By analyzing the context of the budgetary balance evolution in the other countries as well, we can assume that the trend was the same in the Czech Republic, Poland, Slovenia and Slovakia, while in the case of Bulgaria, there is a significant increase in the budgetary surplus. A spectacular evolution has been noticed in Estonia, going from budgetary deficit in 2000 to budgetary surplus in 2007. Hungary is the only country in the EU that had a negative evolution, materialized in the decrease in the budgetary deficit from 2.9% in 2000 to 5.5% in the GDP in 2007, especially between 2002 and 2006, when the registere levels had been significantly higher, namely between 6.5% and 9.2 (EUROSTAT).

By correlating this trends to the data regarding the immixture of foreign direct investments in the economy, one may distinguish three groups of Central and Eastern European states (table nr.2).

Table 2. The FDI – Budgetary deficit/surplus for the CEE states

	ISDS	**ISDNS**
Decrease of the budgetary deficit/ Increase of the budgetary surplus	**1** Estonia, Czech Republic, Slovakia, Bulgaria	**3** Slovenia, Poland, **Romania**
Increase of the budgetary deficit	**2** Hungary	

Source: Eurostat

We must emphasize that we don't claim to establish the net effect of the FDI inflows on the budget of the host country, given the vast diversity of agents influencing the balance of the budgetary exercise. As an example, in the case of Central and Eastern European states that adhered to the EU in 2004, the budgetary effort has significantly risen due to the conformation to the obligations resulting from the membership, namely the one of contributing to the development of the European budget. Meanwhile, the new Eastern and Central Europe members, as well as the adherence candidates, have benefited by significant amounts from the EU budget in order to develop a series of project that have been fulfilled by co-financing from the state budgets. The result of the budgetary exercise is also influenced by the conjuncture factors. In this respect, the best example is Romania, which has experienced an additional pressure on the budget, given the floods in the last years.

The effects of the attracted foreign direct investments flows have reflected in the budgetary deficit, its evolution having been influenced in both direct and indirect manner by foreign capital. Until 2002, FDIs mostly headed towards privatization and being in the deployment stage, had contributed to the depression of the budgetary deficit. Subsequently, as a result of foreign investors concerning on developing activities “on an empty place” and hitting the maturity stage for most of the implemented investments in the anterior period, foreign direct investments have had a positive impact on the budgetary deficit materialized in the increase in the fees and taxes incomes and the decrease in the social expenditures (creating new jobs with a positive impact on unemployment rate).

As a consequence, there are a lot of factors that can influence in a way or another result of the budgetary exercise. Though, the presented data show that hitting the maturity phase of the foreign direct investments in Romania and the other Central and Eastern European states that make the subject of the analysis, the net impact on the budget was positive, and, in some cases, even significant, the best examples being Estonia and Bulgaria.

4. FDI Impact on the Workforce

This subchapter analyses the situation in Romania in order to see if between 2000 and 2010, the modification of the “annual unemployment rate” indicator influenced the modification of FDI and to which extent.

Table 3. FDI-unemployment correlation in Romania

	2000	2001	2002	2003	2004	2005
Annual unemployment rate (%)	7.3	6.8	8.6	7	8.1	7.2
FDI (million $)	1 056.75	1 157.93	1 140.65	2 196.3	6 435.59	6 482.86

	2006	2007	2008	2009	2010
Annual unemployment rate (%)	7.3	6.4	5.8	7.8	6.87
FDI (million $)	11 366.87	9 922.83	13 305.01	6 792.8	3573.297

Source: Eurostat, www. ec.europa.eu/eurostat

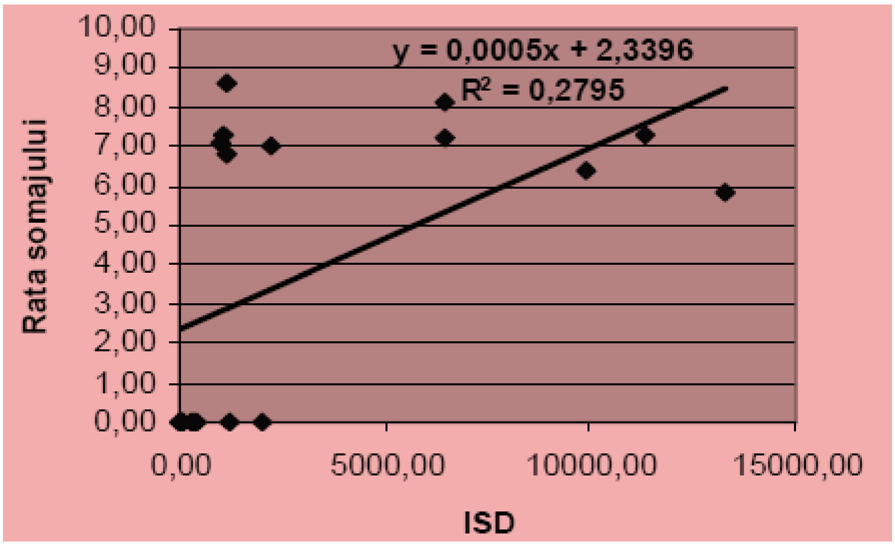

Figure 1. FDI and Unemployment in Romania

Source: Own processing on Table 1

Regarding the situation in Romania, as one can notice in the figure above, there is a relative weak and same orientation correlation between unemployment rate and the FDI level, the R2 value being 0.2795. Between 1990 and 2008, the unemployment rate did not suffer significant modifications, dropping by 1.3% (from 7.10% in 1999 to 5.8% in 2008[1]) and the level of FDI experienced a significant increase.

The FDI effects on the local workforce substantially depend on the following factors: size and investment type, the way foreign investors enter the market, the concerned field, the strategy of investing companies, specific conditions in the host country.

The size of the investment (company) afflicts the local workforce in both quantitative and qualitative manners.

In point of quantity, the transnational companies, though low numbered (almost 2% of the foreign capital companies) attract most of the workforce (more than 60% of the employees in foreign capital companies), compared to small and medium investors that represent the majority, but which attract just a small number in the local employees (almost 35%)[2].

In point of quality, the size and financial power of the company determine the extent to which it involves in the training process and professional forming of its

[1] www.insse.ro.
[2] www.eurostat.com.

employees. This is the main reason why the training activities are more numerous in the case of large transnational companies (such as mobile and financial companies) comparing to small and medium size companies. In the same time, the transnational companies, due to the competitive behavior and own technologies, generate, in most cases, a lower number of workplaces that the same size local companies. The type of investment, respectively its motivation, represents another major factor of the FDI impact on human resources. Thus, in the case of foreign investments motivated by the low cost of the labor force (for the fields that are work intensive) and/or the labor force quality, the features of the local human resource influences in a significant manner the investment decision, being the main localization advantage of the host country. The entering modality of foreign investors influences in a quantitative manner the structure of the active population. Thus, by "Greenfield" investments, new workplaces are created, with positive effects on occupancy. The situation is completely different in the case of attracted FDI in the process of privatization, because the purchased companies are faced with, in a general manner, dramatic personnel reductions, as a result of activity reorganization, with a negative impact on the labor market. Though, within the context where the foreign investors succeeds in, by activity efficiency, saving the company from bankruptcy, on a long term, the registered effect is positive, due to the maintenance of some workplaces.

The activity field of the company influences in a both quantitative and qualitative manner the local workforce. Thus, depending on the product type (labor, capital or work intensive) one of the factors of production may prevail. In the case when the predominant factor is work, foreign direct investments have a significant quantitative impact on the labor force.

The strategy used by the investing company has direct effects on the local labor force, under quantitative aspect. Thus, in the case when the multinational company produces directly in the host country, the impact is far more significant than in the case when it establishes only distribution subsidiaries. One can notice that in the case of Romania as well as in the case of the other Central and Eastern European countries, both strategies were adopted – direct production and distribution network.

We assess that the impact of foreign direct investment on the quality of the labor force consists in both positive contribution, materialized in the positive dynamics of the salaries and in the optimization of the employees' training, as well as in negative economic and social long term effects, due to the dramatic increase in the number of professional decays. Moreover, as a result of the fact that most of the foreign capital has been headed towards intensive work activities, to the detriment of the ones based on knowledge and technology, the positive contributions are relatively low, limited to several activity fields in the field of services (financial brokerage and telecommunications).

5. Conclusions

A continuous and sustained economic growth is possible only under the conditions of a harmonious development, which has to include all the regions in the country, the attenuation of regional gaps, including the concernment of foreign capital, it should represent a real priority of the decision factors. In consideration of the quality of Romania as a member state of the EU, the significant growth of the European funds absorption level and their efficient use should represent a real priority of the decision factors, as the cohesion and structural funds can significantly contribute to the development of physical and institutional infrastructure. Through the effects on productivity, efficiency and competitiveness of the economic activities, foreign direct investments have contributed to the reorganization of the Romanian economy, in the sense of developing certain fields of activity in the manufacturing industry (such as means of road transport) or in the services sector (trade, telecommunications and financial intermediation) concomitant with the restraint of activities in other industrial fields (such as the industry of construction materials).

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