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Comparative study on the legislative framework for attracting FDI in Romania

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Abstract. *In this paper we tried to outline the definitional framework of FDI, starting from the definition and way of achieving FDI, until the presentation of some concise notions from the specialized literature with the aim of establishing what are the determinants of FDI and what are the positive and negative effects on which they generate in the host economies. We paid attention to the game framework in which FDI manifests itself and carried out a critical analysis on the attractiveness of the legislative framework in Romania for foreign investors. The analysis goes beyond national borders and extends to Bulgaria, the Czech Republic, Poland and Hungary, as we consider that the states in the region, members of the EU and with a similar transition history, represent formidable rivals for Romania in the race to attract FDI.*

Keywords: foreign direct investment, determinants, components, host countries, developments, perspectives.

JEL Classification: E20, E22.

Introduction

The successful experiences in attracting FDI recorded by countries such as Ireland, Poland or Costa Rica prove the need for active policies, embodied in efforts to attract and guide foreign investments, which selectively target certain sectors or industries, in order to combine the interest of investors with the objectives general development of the host country. Given recent global developments, the key to success in attracting FDI at the present time is permanent dynamism in the design of public policies and the legislative framework.

With a strategic geographical position, a large market and low labor costs, Romania has a consistent set of attractive factors for FDI, able to transform it into a priority destination for foreign capital after the economic opening of the early years. 90. At the same time, however, the inert legislative framework, along with the lack of measures aimed at attracting investors, to which is added the political instability of recent years, represent a good part of the reasons why Romania is not today a pole of FDI in the region.

The objective of this study is to mark the main attributes of the Romanian institutional environment regarding FDI in two directions (analysis of measures to stimulate FDI and evaluation of the quality of the general institutional environment) and to highlight the existing differences from this perspective between Romania and the countries in the region (Bulgaria, the Czech Republic, Poland and Hungary).

We believe that it is opportune to evaluate the Romanian institutional environment from the perspective of FDI by referring to these countries as they all share a similar history in terms of the economic and political regime before 1989, the transformations achieved during the 1990s in the process of transition to the market economy and the efforts made in the 2000s for EU accession. From this perspective, each of the five states started at the same time in the race to attract FDI, but the results are significantly different between Romania and the other four countries in the region.

1. Literature review

Analysis of the impact of foreign direct investment and the impact on national economies have been topics on the agenda of several researchers. In this sense, we mention Albu (2007), who was concerned with the impact of direct investments on the labor market and the macroeconomic evolution in Romania. Alfaro et al. (2004) analyzed the role of local financial markets in the relationship between foreign investment and economic growth. Anghelache et al. (2016a) studied the connection between foreign direct investments and exports in Romania. Anghelache et al. (2016b) analyzed the correlation between the evolution of the Gross Domestic Product and foreign direct investments with the help of econometric models. Anghelache et al. (2015) conducted a research on the evolution of foreign direct investment flows. Carkovic and Levine (2005) studied how foreign direct investment accelerates economic growth. Cicak and Soric (2015) studied the relationship between foreign direct investment and gross domestic product in transition European countries. Darvas (2020) is concerned with the ability of European Union member countries to absorb and spend well the financing for recovery and resilience. Cîrlig et al. (2021) are concerned with the outcomes of the trade and cooperation agreement between the European Union and the United Kingdom of Great Britain and Northern Ireland. Kogut-Jaworska (2015) is concerned with the identification of smart specializations in Polish regions in the context of the new financial perspective of the European Union for the period 2014-2020. Manning et al. (2012) are concerned with the evolution of sustainability standards of national economies in a global context. Margaras (2020) is concerned with specific flexibility measures regarding ESI funds in response to the coronavirus outbreak. Socol et al. (2013) were concerned with the evolution of foreign investments in Romania and what was the impact of these inventions on economic growth.

2. Data, results and discussion

Romania's low performances in attracting foreign investments have several sources related to the legislative framework after 1990.

A first cause is the lack of a strategic document that specifically refers to the stimulation of FDI. The existence of a strategy for attracting FDI is essential for determining the economy's expectations from FDI, as well as for establishing its role and importance for economic development.

Starting from 2008, the Industrial Policy Documents, the closest to what Romania has known as a strategy for foreign investments, were no longer conceived. After this date they were replaced by the strategies developed as obligations assumed as a member of the European Union, far too general to fulfil the necessary role from the perspective of stimulating FDI.

The lack of strategic investment-attracting sectors is another source of uncertainty for investors, who have no choice but to make investment decisions based on flair. The Government Strategy for the Improvement and Development of the Business Environment of 2010 clearly suggests the lack of a strategic document for the improvement of the business environment, which has in mind the orientation of future government policies regarding this aspect, of a national strategy or policy for the establishment of business support and research and development structures and an economic country brand.

The second cause resides in the lack of economic levers to attract FDI. Instead, Romania has a system of generalized fiscal and financial facilities, applicable mainly to large companies, which does not differentiate between domestic and foreign investors. There are two state aid schemes for which both domestic and foreign firms can apply:

- State aid scheme for supporting investments that promote regional development by creating jobs (HG 332/2014), which considers all economic sectors. The aid is offered by region, and the investor is obliged to create at least 20 new jobs, of which at least 3 are for disadvantaged workers.
- State aid scheme with the objective of stimulating investments with a major impact on the economy (HG 807/2014), dedicated to all economic sectors. The aid granted is non-refundable and differs according to the region of implantation of the investment.

The third reason relates to the low efficiency of the Romanian investment attraction agencies, which did not suggest that they would have a strong position as a negotiating partner for foreign investors or as a government representative. Unfortunately, Romania does not have the experience of a successful agency in attracting FDI. Changes regarding the public institution with which the foreign investor should come into contact are frequent (name change, transfer of control from the Government to the ministries, etc.), which draws attention to the lack of consistency in the promotion of FDI. Although a good part of the responsibilities in the promotion of FDI are transferred from one institution to another with the change of the agency's name, its simple renaming or the transfer of coordination from the Government to the Ministry of Economy and vice versa can prove disruptive for investors.

Romania has had 6 investment attraction agencies in 26 years, currently the institution in charge of attracting foreign investment is the Foreign Investment Directorate (Invest Romania), located within the Ministry for the Business Environment, Commerce and Entrepreneurship. The fact that it is an integral part of a wider department increases the institution's lack of visibility for foreign investors and may suggest that Romania is not so interested in attracting foreign investment.

Romania has a serious competition, represented by the states in the region, which give greater importance to these aspects dedicated to foreign investors.

Bulgaria has a system of investment incentives regulated by the Law on the Promotion of Investments, adopted in 2004 and revised in 2015. The existence of a strategy in this area, unlike Romania, gives it the opportunity to establish the priority sectors for investments: the manufacturing industry and other six service sectors (high-tech activities in information technology, research and development, accounting, tax and audit services, education and health, goods storage). The volume of subsidies depends on the type of certificate for the investment project: class A, class B, class C or priority investment project. In order to benefit from the financial support, a minimum investment amount is required, different depending on the investment class and the sector (industry or services). Priority projects consider very large investments (an investment three times higher than for investment class A) or those located in development, industrial or hi-tech parks.

Beneficiaries of these certificates have the possibility of applying to a wide range of incentive measures, such as: the right to purchase real estate located near the place of investment without following the usual auction procedures; access to financing for the construction of the necessary technical infrastructure; financing the professional training of people employed by investors; reducing by a third the period of approval of the documentation necessary for the implementation and realization of the investment project; administrative assistance provided by the Bulgarian Investment Agency to obtain the documents required by the legislation in order to implement the project; partial reimbursement of social and health insurance contributions for newly employed persons for a period of 24 months.

The Czech Republic has built a strong investment agency (Czech Invest) that has an active role in supporting and coordinating investors in order to increase the added value that investments bring, a good practice model for Romania. Among the main attributions of the agency are: the identification of potential suppliers according to the needs of the investor, the organization of visits to their headquarters and the provision of interpretation services; organization of Business-to-business events – supplier days; managing a comprehensive database of Czech companies in 10 key fields that can be suggested as business partners to foreign investors and that can be accessed online; managing a database with companies in industry, IT or start-ups, which can become business partners of foreign investors through the creation of joint-ventures, the realization of mergers and acquisitions; management of 364 industrial zones, 301 industrial parks, 17 science parks, 168 service buildings and 509 abandoned industrial zones.

At the same time, the Czech Republic has a sectoral selective policy from the perspective of attracting FDI, so investment incentives are granted for three main sectors: manufacturing industry, technological centers (research and development centers) and service centers for business support, such as the development of software, shared services, high tech repairs, customer support (call center).

The tax incentives granted by the Czech state take the form of a profit tax exemption for a period of up to 10 years (in the case of the creation of a new company – greenfield investments) or a partial reduction of the profit tax for the same period (for the expansion of a company – brownfield investments). Also, subsidies for job creation, training and retraining are directed only to regions with an unemployment rate 25% higher than the national average and to special industrial zones. Grants differ in value by region. Cash grants for capital investments are also up to 10% of eligible investment costs and only concern strategic sectors (manufacturing industry and technology centers). Last but not least, property tax exemption for a period of up to five years is granted to investments made in special industrial zones.

Unlike Romania, Poland has a medium-term vision for attracting investments, developed through the 12-year program for supporting investments of major importance, for the period 2011-2023, and which represents the main basis for granting subsidies. The Polish government has established 7 priority sectors for state aid: the automotive sector, the electrical and electronic appliances sector, aviation, biotechnology, food processing, modern services and research and development. In addition, support is also granted to companies that make significant investments with a productive purpose in other sectors.

The criteria for granting state aid are clear: support is provided either for the creation of new jobs or for new investments. In the first case, the level of the subsidy depends on the number of new jobs created, the share of people with higher education employed, the location of the investment, the attractiveness of the products made for international markets or the complexity of the processes offered by the company (in the case of services). In the second case, the subsidy is granted depending on the number of newly created jobs, the investment expenditure per employee and the location of the investment. In addition, incentives are provided for investment in special economic zones in the form of exemption from corporate tax. Poland currently has 14 special economic zones and 76 industrial parks.

The Polish Information and Foreign Investment Agency (PAIilZ) facilitates the contact of investors with central and local authorities, deals with the identification of suppliers and contractors and provides information about the legal and economic environment. In addition, the agency directly intervenes in the establishment of priority investment projects and takes care of the document flow for obtaining financial support from the state. Also, the Ministry of Economic Development has two other departments involved in attracting investments: the Department of Support for Large Investments and the Department of International Cooperation.

In Hungary, the Investment and Trade Agency (HIPA) was launched in 2011, currently it has representative offices in 6 regional centers in the country and a network of 111 representative offices operating internationally, in 76 countries, in addition to diplomatic services of Hungary. The agency manages 9 business sectors: automotive, electronics, information and communication technology, shared service centers, logistics, food industry, life sciences, medical technology, renewable energy.

The investment incentives system is developed and varied, the most important components being the following:

- Fiscal incentives: Hungary taxes new investments and those in research and development differently. Tax exemptions or reductions are granted for holding structures, capital gains from holding shares and intellectual property rights, as well as royalty income.
- Tax facilities for development: Hungary grants an exemption from payment of 80% of the profit tax for a period of 10 years from the date of implementation of the investment. The exemption is granted for investments that exceed a certain threshold or create new jobs, and depends on the sector or region where they are located. The advantageous tax regime in terms of corporate tax (which has a level of 9%) and royalties, as well as favorable legislation on holding companies, have turned Hungary into a tax haven for special purpose entities and companies registered in offshore financial centers.
- VIP investment subsidies: these are made available by the Government mainly for the production sectors, shared service centers and research and development, and are granted in cash, for the creation of new jobs and for the training of employees. At the same time, for investments below 10 million Euros, the Hungarian Government encourages participation in tenders for European funds.

Evaluation of the general institutional environment in Central and Eastern European states

The development of a legislative framework favorable to the conduct of business falls into the category of created resources, which have begun to represent decisive factors for attracting FDI, to the detriment of the traditional determinants of investments. The main consequence is that public policy makers can no longer attract investors with the prospect of natural resource endowments, cheap labor and simplistic tax incentives alone. The locational advantages offered by countries no longer depend so much on the availability, cost and quality of natural resources, but on created resources, such as the legislative framework and institutional infrastructure, intellectual capital, innovative systems, etc.

In order to evaluate the quality of the institutional environment in Romania and make the comparison with the countries in the region, we used the set of World Governance Indicators provided by the World Bank, which shows the perception of businesses and citizens on the quality of governance of the economy, as well as the set of indicators of economic freedom promoted by the Heritage Foundation. The dynamic values of these indicators for Romania and the other four countries in the region in the period 2005-2020 were considered.

From the perspective of economic governance, the World Bank proposes five indicators, as follows:

1) Political stability and absence of violence, which reflects the perception of the incidence of the risk of political instability and violence, including terrorism.
2) Government efficiency, which expresses public perceptions of the quality of public services and their degree of independence from political pressures, the quality of public policy formulation and implementation, and the credibility of government commitment to these policies.
3) Quality of regulation, which captures the ability of governments to implement sound policies and regulations that lead to private sector development.
4) Respect for the rule of law, which measures the degree of respect and trust in the rules of society and, especially, in the quality of the execution of contracts, respect for property rights and courts of law, to which is added the probability of the occurrence of crimes and violence.
5) Corruption control, which expresses the perception of the degree to which public power is used in private interest, corruption at the level of governments and public officials, trust in politicians, bribery in various fields.

In terms of political stability and absence of violence, the Czech Republic's progress is particularly good in the period 2005-2010, and in the following years it strengthens its position and ends up having the highest performance in this perspective. Romania's position is gradually improving in the period 2010-2015, but it will experience a regression in 2020. Bulgaria is in the same situation, with a very low score in the last year, after the previously recorded increases. Thus, Romania has a slow progress, but insufficient to catch up with the other states in the region. As for government efficiency, Romania is the only country in the region that continues to register a negative value of the indicator throughout the analyzed period. Bulgaria, in the same situation as Romania in 2005, however, improves its situation substantially until 2020. Again, we note the outstanding performances of the Czech Republic, which consolidates its position from 2005 until 2020 and is the performer of the region today.

The quality of regulation shows a better evolution for Romania, in the sense of improving the indicator and a constant increase, except for the last year analyzed (2020). Only Bulgaria has a weaker performance, but quite close to Romania's. The Czech Republic has, again, the best performance in the region from the perspective of this indicator. Respect for the rule of law shows an upward evolution of Romania, but compared to the states in the region, we are better positioned only in relation to Bulgaria, which registers the lowest score for this indicator.

Corruption control shows a disappointing evolution in Romania, the indicator being negative throughout the analyzed period, although with improvement trends. Only Bulgaria has a worse situation in the last two years, although in the first period of the analysis it performed better than our country. Poland takes the lead in the region in 2015, having the best ability to control corruption.

Overall, Romania progressed very slowly, throughout the period, from the perspective of governance indicators, continuing to record very low values for government efficiency and corruption control. It seems that 15 years have not been enough to bring us back to these criteria of governance. With the exception of Bulgaria, we have the worst performance in the region. On the other hand, since the best performing country in 2000, the quality of governance in Hungary is gradually getting worse. The Czech Republic is making remarkable progress in this area and has the highest score in the region for four of the five indicators in 2015.

From the perspective of economic freedom in a country, the Heritage Foundation provides a series of indicators that complement the analysis of the legislative framework. The Global Indicator of Economic Freedom comprises 12 other indicators, categorized by respect for laws and the rule of law, size of government, regulatory effectiveness and market openness.

In the following we will analyze the evolution of economic freedom in the five countries in the region according to the following indicators:
1) Fiscal freedom – measures the impact of the fiscal burden.
2) Investment freedom – refers to the lack of obstacles to the flow of capital investments.
3) Financial freedom – measures the independence of the financial sector from government control.
4) Freedom to do business – assesses the extent to which the level of regulation and bureaucracy affects the efficient operation of companies.

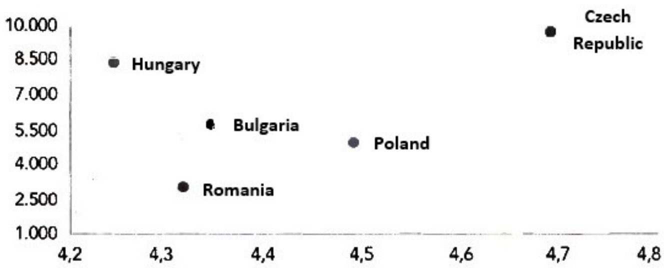
From the perspective of these indicators, the situation in the states of the region tends to harmonize in 2020 compared to 2005, and the scores recorded by the five countries to come closer. Romania manages to improve its performance for three of the five analyzed indicators, so that in 2020 Romania is in one of the first two positions in terms of fiscal and investment freedom and the ease of running a business. Instead, we are in last place in terms of financial freedom, with the same score as in 2005, without managing to improve our situation in 15 years. It is serious that even in the general indicator, of economic freedom, we register the lowest score among the states in the region, the best performance going to the Czech Republic.

The results demonstrate a lack of interest in improving Romania's performance in terms of the quality of the legislative environment. The Czech Republic, on the other hand, has made remarkable progress over the past 15 years and manages to be, in general, in the first place both in creating an incentive framework favorable to investors and in increasing the quality of the legislative environment and facilitating the conduct of business.

The Czech Republic is one of the preferred destinations for foreign investors in the region. The problem for Romania is the following: what kind of investments and with what added value will we attract, given that both Romania and the Czech Republic are targeted by investors from the same countries? There is no risk that, under the conditions in which the Czech Republic performs and Romania stagnates, our neighbor will attract FDI flows with a higher added value – for which it offers better conditions (for example, Czech investments in research – development, stimulation of the sectors high-tech), and Romania should have investments oriented more towards exploiting resources (such as cheap labor) or a high consumer market? The risk, in this case, is high for our country, because once you enter this trend, we will not be able to reverse it very easily.

From the perspective of the competitiveness index, the Czech Republic registers the best performances in the region, it also occupies the first places among sub-indicators such as tertiary education and vocational training, labor market efficiency, macroeconomic framework and infrastructure. The other analyzed countries have close values of the competitiveness index, between 4.25 and 4.49, and Romania and Bulgaria register the same score (4.32).

Figure 1. *Relationship between FDI per capita (EUR – vertical) and competitiveness index (horizontal) in 2020*

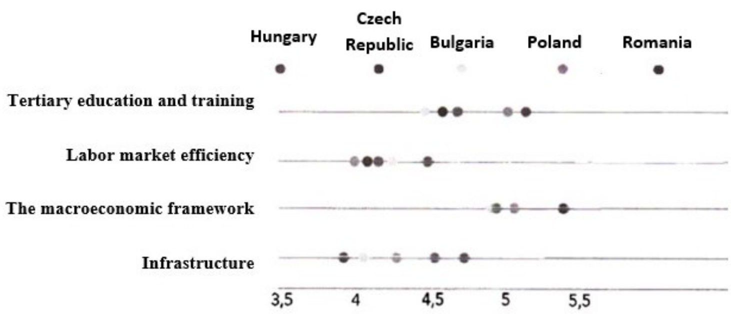


Source: World Bank. Data processed by the authors.

Of the 12 pillars of competitiveness, four were chosen to highlight performance differences between countries. Thus, although Romania has the second most stable macroeconomic framework after the Czech Republic, it is in the last positions among the other indicators (infrastructure, tertiary education and professional training, efficiency of the labor market.

Romania has the second most stable macroeconomic framework, but the weakest infrastructure.

Figure 2. *Under competitiveness indicators*



Source: World Bank. Data processed by the authors.

Maintaining stability from a macroeconomic point of view gives confidence in the country receiving FDI, but foreign investors are also looking at other aspects for business development, such as workforce training or infrastructure, aspects that highlight Romania's poor performance in attracting FDI, compared to Poland, the Czech Republic or Hungary.

One of the sub-indicators that the 5 economies have in common is that of labor market efficiency. It aims at: the flexibility of changing workers from one sector to another depending on labor needs and changes in the economy, incentives for employees, the promotion of meritocracy, a business environment in which there are equal opportunities between women and men, etc. The only country among those analyzed that shows a slightly better labor market performance is the Czech Republic.

Romania climbed 37 positions in the ranking regarding the attractiveness of the business environment in the period 2017-2020, having a better performance than Hungary and Bulgaria.

Table 1. *Attractiveness of the business environment*

Country	2017	2018	2019	2020
Romania	73	48	35	36
Poland	45	32	25	24
Hungary	54	54	40	41
Czech Republic	75	44	26	27
Bulgaria	58	58	37	39

Source: World Bank.

Romania climbed 37 positions in the global ranking regarding the attractiveness of the business environment from 73rd place in 2017 to 36th place in 2020 (according to the World Bank, presented in Table 1). This performance was due to the reduction of taxes for companies (e.g. social contributions X of the improvement the way of paying taxes through electronic systems, facilitating the execution of contracts and improving the insolvency process (e.g. the introduction of deadlines for the observation period and the implementation of the reorganization plan). Although the attractiveness of the business environment has significantly improved in Romania in the last four years, FDI flows have not seen a significant increase in the same period, which indicates that reforms regarding the business environment, in education, the labor market, infrastructure, etc., should be continued.

The Czech Republic advanced 48 positions in the Doing Business ranking from 2017 to 2020, being the best performer among the countries analyzed. Its result was due to measures such as reducing the time and minimum capital required to open a company, facilitating access to credit, improving the execution of contracts.

Among the analyzed countries, Hungary is the one that climbed the fewest positions in the ranking of the attractiveness of the business environment in the analyzed interval. The process of setting up a new company was made more difficult by the measure taken by Hungary to increase the capital required to open a business.

3. Conclusions

From the study done and presented in this article, some conclusions can be drawn. A first conclusion is that after 1990, Romania did not have a coherent vision or objectives that would indicate the engine of economic development in the future, in the context of an increasingly integrated economy at the global level.

Another conclusion is that the industrial parks and clusters intended to improve the business environment in Romania are heavily concentrated in the already developed areas of the country and are not fully functional. Romania needs clear performance criteria (for example, number of jobs created, region of implementation of investors, volume of research, development and innovation expenditure, etc.) on the basis of which to grant fiscal and financial facilities to investors, so that the contribution brought by foreign investment in Romania can be concretely evaluated.

A final conclusion that emerges from this study concerns the quality of the legislative environment in Romania, which is currently unable to face the competition of the states in the region. Therefore, Romania risks being overlooked by investors. The progress recorded in certain fields is not enough, because they did not exceed the efforts made by the other countries, which showed a higher efficiency in the construction of the legislative environment regarding foreign investments.

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