FOREIGN DIRECT INVESTMENTS AND DOMESTIC INVESTMENTS IN ROMANIA IN THE ECONOMIC CRISIS PERIOD

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Abstract

Investments represent one of the most important factors of the economic growth as well as of the exit from crisis and economic re-launching. The paper analyses the investments evolution (foreign and domestic) in Romania under the crisis circumstances, taking into account the main factors of influence. Based on the analysis of Romania's investment process, in the period 2005-2010, several proposals are made aiming at the improvement of investment mechanisms and their sources of funding, including the increase in Romania's absorption capacity of EU structural and cohesion funds in the period 2007-2013.

Key-words: *investment, economic growth, foreign and domestic investments, economic crisis, sources of funding*

JEL Classification: G_{11}, E_{22}

Introduction

Economic and financial crisis triggered in September 2008 by the U.S. bank Lehman Brothers bankruptcy was a first evident signal of financial system crisis with implications at both international and national levels. Contagion phenomenon was rapidly diffused since U.S. investment bank has international relations with other countries in the global economy. Directly or indirectly, the effect of the crisis has spread to the European countries including Romania.

In this paper we present the impact of current economic and financial crisis on the investment process in Romania during 2008-2010 as regards the features of volume, structure and dynamics of FDI and domestic investment.

I. Macroeconomic Developments

We will try to present a first approach of the impact of economic crisis in Romania based on analysis of the main macroeconomic developments in the period 2008-2010 in the detachment to draw conclusions about the causal correlation between the effect of some indicators (GDP, industrial production, trade, services) and effort indicators (domestic investment, foreign direct investment, employment).

Table 1

Main macroeconomic indicators

Period	Gross domestic product		Investments in national economy Annual rate of growth %	Services provided to the population Annual rate of growth %	Current account balance (million euros)	Foreign Direct Investment (million euros)	Unemployment	
	Nominal (million lei)	Real annual rate of growth (%)					No. Total registered unemployed (thousand persons)	Registered unemployment rate (%)
2005	288954,6	4.2	10.8	11.9	-6888	5237	523.0	5.9
2006	344650.6	7.9	19.7	28.2	-10156	8723	460.5	5.2
2007	416006.8	6.3	20.9	9.6	-16714	7047	367.8	4.1
2008	514654.0	7.3	17.1	2.3	-16157	9308	403,4	4,4
2009	491273,0	-7.1	-29.1	-15.6	-5168	4400	709,4	7,8
2009								
Q1	96616,7	-6.2	2.7	-6.1	-910	1471	513,6	5,6
Q2	112073,0	-8.7	-29.7	-19.2	-2431	2593	548,9	6,0
Q3	130288,7	-7.1	-30.6	-20.4	-3493	3669	625,1	6,9
Q4	152295,3	-6.5	-39.9	-14.6	-5168	4400	709,4	7,8
2010 Jan.	x	x	x	8.8	-144	274	741,0	8,1
Febr.	x	x	x	8.0	-754	445	762,4	8,3

Source: National Institute of Statistics, Ministry of Finance, National Bank of Romania.

Main conclusions residing in the macroeconomic analysis presented in table 1 are:

– in 2009 the volume of investment dropped by – 29.1 in comparison with 2008; this is the most severe decline among macroeconomic indicators;

– the economic crisis had a powerful negative impact on services provided to the population from 6% in the quarter to 20% in the third quarter;

– FDI share in GDP in 2009 was 3.78% versus 6.6% in 2008, which shows a decrease of almost 50% of foreign direct investment to economic growth in Romania;

– more worrying is the situation of FDI in the first two months of 2010, when net FDI volume was 274 million euros, 445 million euros respectively, compared with a monthly current account balance of – 144 million euros, respectively – 754 million euros; this discrepancy between FDI and current account balance raises a very serious problem for sources of financing the current account deficit and external debt because some of funding resources declined, particularly, a foreign inflows of remittances from Romanian workers abroad (free currency transfer) and the proceedings from state-owned assets privatization;

– the number of unemployed increased from 403,400 persons in 2008 to 709,400 persons in 2009 (unemployment rate increased from 4.4% in 2008 to 8.3% in February 2010), as a consequence of the large number of insolvencies and bankruptcy of enterprises.

II. **Volume and gross total investment growth**

Part II examines dynamic volume and gross total investment in Romania in 2005-2009, with forecasts for 2010 and 2011 compared with the EU-countries.

Table 2

Gross capital formation in Romania and other EU countries in 2005-2011

(million euro)

Country	2005	2006	2007	2008	2009	2010	2011
EU-27	2210746,9	2416051,,	2633239,3	2633918,8	2262853,6	2239639,8	2331916,9
Bulgaria	5278,8	6533,3	8588,0	11354,0	8377,6	7757,1	:
Germany	390080,0	422800,0	455530,0	474710,0	430640,0	440715,7	461277,1
France	344370,0	373205,0	408776,0	427208,5	399942,6	400215,6	415306,9
Hungary	20422,8	19531,1	21406,6	22102,9	18639,7	20783,1	22484,4
Poland	44572,1	53412,3	67124,1	80038,5	65171,1	73204,2	77762,2
România	18930,0	25006,2	37618,4	44637,1	29675,8	32425,9	35797,9

Source: Eurostat.

In 2008 compared to 2005, total EU-27 investments increased by 1.2 times. In 2009 over 2008 the increase of investments was only 15.0 %.

Table 3

Indices of gross capital formation (investment) in Romania compared to EU-27 and some EU members (%)

Country	2008/2005	2009/2008	2010/2009	2011/2009
România	235	66	109	121
EU-27	119	86	99	103
Bulgaria	215	73	93	:
Germany	112	90	102	107
France	124	94	100	104
Hungary	108	84	111	120
Poland	179	81	112	119

Source: own calculations based on Eurostat.

From table 3 states we point out the following conclusions:

– in 2005-2008 the volume of investments at the macroeconomic level increased in all analyzed countries, Romania registering the largest increase, 2.4 times; substantial increases were also found in other transition countries (Bulgaria, Poland), but also in developed countries such as France and Germany;

– the crisis has affected most of the investment processes in Romania, 34% decrease in 2009 compared to 2008, in other countries examined the decline of investments ranged from – 19% (in Poland) to – 6% in France; it can thus be noted that relatively less developed countries had suffered a stronger shock from the crisis than developed ones;

– according to forecasts in the years 2010-2011, the investment process will be resumed in all EU countries.

It can be concluded that EU countries with lower levels of economic and social development than the average EU level of vulnerability showed significantly higher than that of developed countries, and also were characterized by the development of investments more variable from year to year, which aimed at finding supports for the relative fragility of economic development in these countries.

III. **Causes of the drastic decline in FDI and domestic investment**

It is obvious that under stress conditions, investment risk increases due to the combined influence of several factors, such as: inflation, exchange rates, interest rates, external debt and medium and long term budget deficit.

Table 4

Macroeconomic explanatory factors of investments

Period	The interest rate charged by credit institutions		Consumer prices (CPI)	Foreign exchange market rate (RON/ EUR)	International Reserves (million)	External debt (million)	External debt service (mil. Euro)	Consolidate budget balance (mil. Euro)
	Loan	On deposits						
2005	21.04	8.34	9.00	3.6234	18259.2	24641.5	5306.1	-2268.4
2006	14.83	6.51	6.56	3.5245	22935.2	28622.2	6499.7	-5651.0
2007	13.32	6.70	4.84	3.3373	27186.8	38711.2	8466.0	-9448.3
2008	15,07	9,55	7,85	3,6827	28269,9	54761,9	13056,1	-24654-9
2009	17,30	11,89	5,46	4,2373	30858,6	65465,2	11958,2	-36400,6
2009								
T1	18,05	14,33	6,77	4,2662	27426,4	52497,3	2416,9	-7925,1
T2	17,76	13,45	6,09	4,1923	28689,9	59020,1	5679,6	-14383,1
T3	16,73	10,65	4,99	4,2247	30615,6	64635,1	7649,3	-25563,2
T4	16,58	9,52	4,56	4,2659	30858,6	65465,2	11958,2	-36400,6
2010 ian.	16,30	9,13	5,20	4,1409	30623,0	65839,4	720,3	+15,3
febr.	15,60	8,60	4,49	4,1179	32465,8	67736,6	2312,8	-5818,8
mar.	...	...	4,20	4,0879	34784,2	...	...	...

Source: National Institute of Statistics, Ministry of Finance, National Bank of Romania.

In the period 2008-2010, we mention the following main aspects concerning the impact of financial crisis:

– is the first period that the crisis inflation did not register jumps very high compared to other periods, however the inflation level varying between 4-5% annually is relatively high;

– increase of taxes on income, salaries and pensions as suggested by Romanian officials is likely to generate a price spike in goods and services which could affect unfavorably the consumption in the next period;

– another factor likely to influence the resumption of investments in Romania is the relatively high interest rate. As shown in table 4, 2008-2010 interest rate credit institutions increased from 15.07% in 2008 to 17.30% in 2009, ending in February 2010 with a decrease to 15.60%*;

– measures to further reduce interest of monetary policy is an instrument to encourage investment by bank loans. Unfortunately, the present level of interest rates charged by commercial banks in Romania is still very high, a substantial investment based on the use of bank loans on long-term not being a reliable solution;

– if the interest rate on loans for investments projects will be compared with the rate of profits generated by these investments continue banking system is favored to the detriment of real economic expansion, situation conducive to a continued split between real and nominal economy to scale unacceptable, counterproductive;

– the relatively large gap of 7-8 per centage points between active and passive interest practiced by commercial banks does not encourage savings;

– while Romania's international reserves increased by 2009 to 30.8 billion Euro, Romania's foreign debt on medium and long terms increased to 67.7 billion Euro;

– increasing external debt on medium and long term, is another factor hampering investment in Romania, as an important part of development through investment financing has to be devoted to foreign debt payment;

– the budget deficit is another parameter with impact on investment, especially public ones. Increasing the budget deficit as a proportion of GDP in the period under review has seen higher levels since 2009 under pressure to reduce budget revenues due to decreased production of goods and services and a relatively high level of spending.

Budget deficit targets agreed with IMF Executive by Romania, as a conditionality of loan, impose budgetary austerity which reduce the future investment volume.

A particular issue that deserves special consideration in terms of foreign direct investment is aimed at foreign-owned investment profitability. It is generally known that foreign-owned firms have higher profitability and higher productivity than the Romanian ones.

IV. **Some conclusions and final remarks**

It is widely recognized both with methodology and practice that the end of the crisis in Romania cannot be achieved without a revival of investment process.

Sources of financing medium and long term investments in Romania could be improved by increasing absorption capacity of EU structural and cohesion funds

* In comparison with the inflation rate of only 5-6 per cent, in this period, the interest rate seems to be too "really positive" and detrimental to economic relanunching.

in accordance with the provisions of Sectoral Operational Programmes in the period 2007-2013.

Currently, Romania has failed to receive EU payments of contributions during 2007-April 2010, only a proportion of 8.76% compared to the total EU allocation for Romania.

This rate Medea low absorption capacity was assigned to various operational programs as: transport 1.19% Average 9.94% 16.36% Regional, Human Resources 6.89% 11.23% competitiveness, administrative capacity 2.02%, 2.22% technical assistance. Compared to other new EU member countries, Romania is on a very low position.

Given the high degree of external openness of the Romanian economy and the essential share of enterprises with foreign direct investment (73% of total Romanian exports, and 62.6% of total imports), the foreign capital in Romania play a particularly important role in surpassing the crisis and the economic recovery in the coming years. This more so since some companies with foreign capital even during the crisis have been relatively high profit making. In this regard, we mention Renault Dacia Company which in 2009 contributed with 10% to the Romanian exports and over 15% of GDP, OMV and Sidex Mittal. In order to contribute to Romania's exit from the crisis these foreign companies must reinvest in our country a large part of their profits.

At the same time, we consider that the revigoration of the domestic investments in both public and private sectors is one of the most powerful determinants of the economic recovery and growth in parallel with FDI.

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