

The Impact of Economic Crisis on Direct Foreign Investments

Lucia Ramona POPA

lucia_ramona10@yahoo.com

*Universitatea "Constantin Brancoveanu" Pitesti
Facultata Management Marketing in Afaceri Economice*

Abstract

The direct foreign investments play an extremely important role in the economic development of a country through technological and know - how transfer, the export promotion with favorable effects on commercial and payments balance by attracting and training the available work force. The world crisis manifested by the restriction of access to financing sources, through some more restrictive loan conditions, the sales reduction, of profits therefore of financing resources destined to self - finance activities, to the achievement of acquisitions and mergers at international levels, as well as the severe reduction of stock exchange causing problems to transnational in financing from the capital market- all this have negatively influenced the direct foreign investment flows.

Keywords: foreign investments, transnational corporations, financial and economic crises.

JEL Code: F39

1. Introduction

The development of a strong economy based on the principles of competitive market cannot be achieved if it is not connected to the world economy in the same way in which the progress and the economic growth cannot be achieved without direct foreign investments.

2. The objectives of the investing and host countries

The flow of foreign investments among countries or groups of countries is made depending on some objectives which differ from a country to another according to their level of economic and technological development, to their economic structure and their being endowed with factors, to their progress in computing and communications, to the institutionalization of financial markets and extention of cooperation at corporation level.

The objectives which lead to the direct investment flows for investing countries are:

- + the supply with raw materials and power resources from host countries;
- + the use of some production factors available in the host country;
- + the use of goods marketing possibilities on the host country markets.

The objectives of the host countries have in view:

- + the achievement of top technologies;
- + retechnologisation with effects on production development and on generation of technical progress;

- ✚ the creation of new working places;
- ✚ the development of new branches;
- ✚ a performant management.

The main generators of direct investment flows abroad are the developed countries because they dispose of important accumulations and of the necessary material, technical and human means as well as of technologies and managerial experience.

3. The reasons lying at the direct foreign investments

The high level of investment flows concentration both at import and export becomes manifested within the groups of countries of European Union, North American and Japan. The greatest direct investment flows take place at the level of developed countries but there are differences among them depending on the extent of the countries, on their economic and technological power, on the structure of production factors and on their technological and managerial experience.

The country markets having national economy under transition rise interest to foreign investors both because of the quality of their work force, and of manufacturing conditions of some good quality products at low costs.

In this way the foreign investors dependence on getting high profits is quite great. However the development of economic globalization processes and the intensification of integration tendencies all over the world and especially in Europe, create for the countries with a transition economy, conditions to manifest some interests similar to the developed countries.

These interests represent:

- ✚ harmonization of levels of economic development and the creation of possibilities to revitalize the economy of host countries under transition;
- ✚ the creation of conditions to use more intensely the resources of work force and creative capacities in their residing countries and the prevention of emigration to the developed countries;
- ✚ the more intense use of raw materials on a longer period of time but under adequate ecological conditions;
- ✚ the consolidation of democratic framework and the assurance of a healthy business environment, based on a competitive economy which create the conditions necessary for the integration process and for the policy of countries under transition.

Besides these convergent interests, the developed countries have a series of personal interests:

- ✚ the assurance of a more stable investments, of capital surplus accumulated on the capital market and in western banks which do not find an advantageous use in their own economy;
- ✚ the creation of new markets for their high-tech competitive products, which without a development of technological level or retechnologisation of the other economies cannot totally find marketing sale on the origin country market;
- ✚ the interest for the capital extension and for the control on other national economy with the view to get profits from these;
- ✚ the tendency to take over the control on some economic entities or sectors of great importance on the way of strategic investments.

4. The effects of foreign investments on countries economy

The effect caused by the foreign capital on the economy has two dimensions. On the one hand this plays a complementary role in the context of transition, as it supplements the limited financial resources of the country and reduces the effects generated by the unstrained state of

economy, and on the other hand they have an important structural role in overcoming inefficiency and difficulties by using modern technological flows, managerial experience and economic administration.

By means of direct foreign investments it can be achieved:

- ✚ making of capital, as FDI contribute to a certain extent to the formation of fixed capital. Thus only the FDI flows out of which are subtracted FDI for the acquisition of production means already existing contribute to the formation of fixed capital that is new investments, reorganization investments, made in order to make some previous acquisitions profitable (assets or corporate stock) and the rise of stock capital in the existing companies.
- ✚ technological transfer and innovation activity. The access to technology and advanced knowledge is more important than the invest amount and technology import determines quite often a research activity for adopting them to the conditions of the host country. From technological perspective FDI determine the introduction of new technology which entails the manufacture and commercialization of a new product or price reduction of an already made product, the introduction and development of new abilities of working with the new technology in case of FDI which also imply the technology flows. This advantage is very important for the host companies as these make use of depreciated and obsolete technology which may lead to the production of low quality goods having weak performances. Since direct investment presupposes the transfer of advanced technology, modern production techniques and know-how, the receiving company will register superior performances as regard productivity and products quality, which will determine the increase of their export competitiveness.
- ✚ impact on competition, on resources, ownership relations and economic policy. Sometimes the impact may also have a negative influence because transnational corporations use the superior market force to annihilate competition. That is why a series of laws as that of bankruptcy, competition, capital market have the role of avoiding such situations;
- ✚ introduction of a new type of management in which the employees are directly interested in the good development of the organization which makes investments in the qualification and specialization of the staff and motivates them professionally and financially;
- ✚ decentralization of activities and the development of market economy in which the competition is regarded as a positive factor of companies in attracting customers with quality goods at competitive prices;
- ✚ attraction of redundant workforce because of reorganization of large companies, of bankruptcy of other societies or from the students attending schools. The impact of FDI on the workforce is influenced by great investors who generate new working places and pay higher wages than national companies, engaging young well-trained specialists, who contribute to the increase of labor productivity. The creation of new working places represents one of the positive effects generated by "greenfield" type investments. The creation of working places which need qualified workforce presupposes transfer of knowledge and the permanent preoccupation for professional training, with favorable effects on the quality of human factor in the host country.
- ✚ the improvement of the level of workforce training when the foreign companies make investments in activities which presuppose a raised qualification of the employees, the foreign investors will pay an increased and permanent attention to the improvement of the staff of the organization receiving them. Furthermore, it may appear the phenomenon of knowledge diffusion acquired like that, if the employees of such companies direct to other sectors or start developing activities on their own.
- ✚ influences on political, social, cultural field through a direct exposition of the economy of the host country to the political and economic system of other countries, attitude towards work, industrial relations and foreign workers, customs and behavior norms different from foreign societies;

- ✚ the use of external market segments proper to those who make investments, balancing imports with exports but also the commercial deficit.
- ✚ export promotion, the improvement of foreign trade structure. In a first stage of transnational expansion, the commercial balance of the host country might be negative because of the massive imports made by the branches- machines, equipments, raw materials, but once the export started, the balance also improves;
- ✚ the appreciation of the exchange rate and of payment balance. In case of FDI it must be made a comparison between the entrance flow of the project and the present value of the future income flows, using as an updating factor the rate of interest on the international market from which the respective country may borrow funds. Usually the future flows updated are higher than the invested capital, because the rate of return in the developing countries is lower than the rate of interest on the international market accessible to these countries. Furthermore by means of FDI, currency is saved by substituting imports and also takes place the appreciation of the exchange rate.
- ✚ decrease of the loan values to which Romania must resort to balance the budget deficit and the commercial one by adding to the GDP of the host county and by supplying supplementary income to the state budget by taxes and fees;
- ✚ the support of privatization and restructuring process. In case of large public companies offered to be sold, when the local companies do not have enough funds for their acquisition and becoming profitable, FDI are the only solution. By privatization they benefit from financial flow, technology, know-how and from the quality of local workforce;
- ✚ the increase of local firm efficiency and competitiveness that will be able to improve qualitatively the management level and that of production, and if they became the suppliers of foreign investors companies, they have access to new technologies or diversify their own production to face the competition caused by the presence of new economic agents on market.

In the same time the FDI may have negative effects on the budget in the implementation stage owing to some tax facilities granted, to the rise of imports through the invested equipments but also the increase of unemployment by reorganization of private companies.

The role of foreign direct investments is to produce a sustainable development within the economy of the host country through the contributions brought to the increase of the level of work force engagement, of the standard of living and of GDP.

5. The Crisis Effect on Direct Foreign Investments

The unusual amplitude registered by the financial and economic crises at international level engendered some major worries regarding the future of world economy. Inevitably under the incidence of crisis effects and of pessimistic forecasting have also entered the direct foreign investments, in spite of their positive evolutions in the recent years.

In the period 2003- 2007, the flows of direct foreign investments have registered an ascending trend, supported by the economic development at world level, by the liberalization of regimes regarding foreign investments and the implementation on a large scale of internalization strategies. All this have led to a DFI high record of 1.8 billion dollars in 2007 (UNCTAD, 2009).

Because of international financial and economic crises the year 2008 marked the end of the rising cycle of international investments.

This, the direct foreign investments flows at global level have decreased with 20% in 2008. As regards the impact on virtual economy, the crisis has rapidly over passed the financial sector and engendered serious effects on the real economy.

The more restrictive credit requirements affected the firm possibilities of development and extension, and the consumers trust has decreased in many parts of the world.

In fact, the crisis impact on D.F.I. flows is different, depending on the region and on the activity sector.

Statistics show that the developed countries were most affected by the crisis in 2008 as a result of the problems met by financial institution, that of liquidities, the direct foreign investment flows have decreased with almost 33% for the group of developed countries.

The drawn DFI flows have registered low levels especially in Finland, Germany, Hungary and Italy but also in Great Britain, France, The United States as compared with the levels registered in 2007.

The low income registered by transnational corporations and by the decline of trade - unionized banking loans limited the investment financing.

Also, the LBO reduced transactions (taking - over companies with funds from loans) affected emergencies and international acquisitions, with negative effects on DFI flows.

As regards the developing and transition countries, the DFI flows to these countries were not affected in the same way as the developed countries in 2008. The rising rate of developing countries, though lower than in 2007 (when it exceeded 20%) has reached 4% according to UNCTAD estimations.

The flows to East, South and South East Asia, (the most important as regards FDI flows, among developing countries) continued to rise in 2008, but with a lower rate than in the preceding year.

The countries in the West Asia recorded a significant reduction of direct foreign investments (over 20%) as compared to 2007, because of low oil demand, of high costs and of low income from oil sales. Instead, while South America expects that the crisis effects on direct foreign investments to be feebly felt, in Central America and Caraipe - that are traditionally dependent on American economy, they will register, most probably, a decline.

At present, the rising strategy based on direct foreign investments of new EU member states and of South- East European Countries is critical according to an analysis on the situation of direct foreign investments in 20 Central, East and South - East European countries made by Vienna Institute for International Economic Studies.

On the basis of world tendencies and of results of the first term of actual year, the representatives of Vienna Institute of International Economic Studies expects that the infusion of direct foreign investments decrease with at least half of the level in 2008.

In spite of this considerable decline, the volume of investments in the EU new member states could reach 20 billion Euros, similar to the volume of investments registered by these countries at the beginning of 2000.

The excessive external exposure has engendered a high vulnerability, especially with the small countries, and facilitated the propagation of financial crisis.

After many years of continuous increase, the infusions of direct foreign investment in the EU new member states have registered a decrease of 9% AND OF 22% in the South- East European countries in 2008. This decrease was compensated by an explosive growth of 17% of direct foreign investments in the Community of Independent States.

The results from the EU new member states were different. While Romania and Slovenia registered significant increase as regards direct foreign investments in 2008, Poland, Bulgaria and The Baltic States have registered decrease. Some of these changes were the results of normal fluctuations caused by ample individual investment projects.

In Czech Republic, Hungary and Slovakia the infusions of direct foreign investments were at the same level as in the previous year, and the investments also continued on projects oriented to exports, in industries which suffered important production decrease at the beginning of this year.

In 2008, Romania was placed the second on top of drawn foreign investments among the new EU member states and was placed on the ninth among the 27 countries of the Union, surpassing Czech Republic, Bulgaria, Hungary but also Denmark, Greece, Holland, Portugal.

It is possible that a large number of production activities be transferred from West Europe to the newly admitted countries in EU. Having low cost levels, and some subsidiaries will be closed in this region. New investment opportunities also appear in the new EU countries on the basis of increased project numbers financed by European Union.

As regards the sectors of activity, the DFI flows to financial services, of automobile industry, to building materials or of some consumer goods were seriously affected.

But the crisis consequences rapidly extend on DFI flows of other sectors, starting with primary sectors and finishing with the non-financing services.

In the same time the present financial crisis influences the firms capacity to invest as a result of reduced financial possibilities and of decreased desire to invest because of pessimistic forecast as regards the economic growth and market development.

The reduced access to financial sources represents an important factor which affects the DFI flows. The financial factors affects negatively the capacity of transnational corporations to invest both at internal level and also external one, as long as the crediting conditions become more restrictive, and reduction of profits leads to the decrease of financial resources destined to investment projects.

On the one hand, the credit offer has decreased and the financing cost has increased. The external financing environment of companies deteriorated at the latter half of 2008, determine the transnational corporations be more reticent as regards foreign investment or mergers and acquisitions.

On the other hand, the low income registered by a series of USA, Europe and Japan industries diminish the company self- financing possibilities.

Besides, a 40% decrease of money market all over the world reduced the financing capacity of transnational corporations on the capital market. The pessimistic forecast regarding the world economy represent another factor which affects the direct foreign investment flows.

The negative process registered all over the world, including the strong recession (even in some developed countries) and a continuous appreciation of risk, reduced the firms capacity to invest for expansion both at internal and international level.

Foreign investors continue to be interested in the Romanian market, despite the international crisis, ARIS receiving 12 investment projects from investors since the beginning of the year, representing investments over 700 mil. Euro, which might create 3000 work places. The main fields in which investors are interested to invest in Romania are those regarding the production of equipments for non conventional energy, building materials and IT.

Among the most significant investments for the increase of social capital, achieved in 2009 are those got in car industry and car equipments, in metallurgy, in banking system and pharmacy.

6. Conclusions

Through direct foreign investments can be achieved: the formation of fixed capital in an organization, the technological transfer and innovating activity, the substantial decrease of production costs and prices; the rise of products quality which are competitive on the external market, export promotion by using foreign market segments- belonging to investors; the reduction of loans Romania has to make to balance the budget deficit and the commercial one; the appreciation of the exchange rate and of balance of payments; the drawing of available work force and their training; decentralization of activities and the development of market economy, the sustainability of privatization and restructuring process; international economic integration, because they determine a better connection with international economy and an amplification of economic growth due to a more efficient international work division and the reduction of their level due to world crisis has consequential effects on the entire Romanian economy.

The liquidity crisis which caused restrictions regarding loans, the reduction of organization income as well as the decrease of stock exchange prevented transnational to achieve foreign investments. The world crisis manifested by the restriction of access to financing sources, through some more restrictive loan conditions, the sales reduction, of profits therefore of financing resources destined to self - finance activities, to the achievement of acquisitions and mergers at international levels, as well as the severe reduction of stock exchange causing problems to transnational in financing from the capital market- all this have negatively influenced the direct foreign investment flows.

Direct foreign investments have become the most important source of foreign financing for the world countries, no matter their level of development, as unlike the bank loans, the portfolio investments are affected in a smaller extent by the financial crises.

References

1. Korten David c. – *Corporațiile conduc lumea*, Ed. Samyidat, București, 2003;
2. - Matei Mirela - *Investițiile străine directe, funcții și evoluții 1990-2000*, Ed. Expert, București, 2004;
3. Mazilu Anda – *Transnaționalele și competitivitatea. O perspectiva est-europeana*, Editura Economică, București, 1999;
4. Miron Dumitru – *Economia integrării europene*, Ed. ASE, București, 2002;
5. Miron Dumitru – *Comerț internațional*, Ed. ASE, București, 2003;
6. Moise Elena - *Investiții străine directe*, Ed. Victor, București, 2005;
7. Munteanu Costea - *Investițiile străine de capital*, Ed. Oscar Print, București, 1995.
8. Munteanu Costea, Horobeț Alexandra – *Finanțarea proiectelor de investiții internaționale*, Ed. ASE, 2002;
9. Munteanu Costea, Horobeț Alexandra – *Finanțe transnaționale: decizia financiară în corporația modernă*, Ed. All Beck, 2003;

10. Negrițoiu Mișu – *Rolul investițiilor străine în strategia națională de dezvoltare economică*, Ed. ASE, București, 1999;
11. Rujan Ovidiu, Pârgaru Ion – *Economie internațională*, Ed. Economică, București, 2004;
12. Krugman, Paul R. - *International economics: theory and policy*, Pearson, Addison - Westfield, Maurice Wesley, 2005;
13. Pike Richard, Weil Bill – *Corporate finance and investment: decisions and strategies*, Prentice hall, 2003;
14. Caballero Ricardo J. & Krishnamurthy Arvind-*Global Imbalances and Financial Fragility*, National Bureau of Economic Research, Inc, NBER Working Papers, nr. 14688, 2009;
15. Fama Eugene; French, Kenneth – *The Capital Asset Pricing Model: Theory and Evidence*, *Journal of Economic Perspectives*, 18, 2004;
16. Liew, Jimmy; Vassalou, Maria – *Can book to market, size and momentum be risk factors that predict economic growth?*, *Journal of Financial Economics*, 57 (2), August 2000;
17. Ozturk Ilhan-*Foreign Direct Investment – Growth Nexus: A Review of The Recent Literature*, Euro-American Association of Economic Development, *International Journal of Applied Econometrics and Quantitative Studies*, 2007;
18. *Index of Economic Freedom*, The Heritage Foundation, *The Wall Street Journal*, New York, 2008
19. *Research Reports 352*, The Vienna Institute for International Economic Studies, Austria, December, 2008;
20. UNCTAD, *World Investment Report: Transnational Corporations and the Infrastructure Challenge*, New York and Geneva, 2008;
21. UNCTAD, *World Investment Report: Transnational Corporations and the Infrastructure Challenge*, New York and Geneva, 2009.