THE FOREIGN DIRECT INVESTMENTS IN ROMANIA – CONTRADICTORIES TRENDS

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Abstract: Romania attracted large inflows of foreign direct investments (FDI), thanks to an improved business environment and still-low labor costs. Romania offers to the foreign investors many major reasons to invest in Romania: great market potential, strategic location, significant natural resources, high skilled labor force, high potential for economic growth, new EU member, infrastructure growing steadily, friendly business environment, access to European funds, competitive taxation. But still there are possible many contradictories evolutions generated both by Romanian government decisions and by the influence of the external factors. Virtually, the size on the above potential shows the countries with low FDI potential but strong FDI performance. The same time, the United Nations Conference on Trade and Development (UNCTAD) matrix considers that Romanian economy has less advantages than the Romanian Agency for Foreign Investment (ARIS) offers. Therefore, Romania is below potential wanted by foreign investors. Therefore many challenges must be addressed to enhance competitiveness and to attract additional FDI. The Foreign Investors Council (the FIC) from Romania believes that Romania must still improve the enforcement of new laws and regulations; tackle major social reforms, including reform of the labor market; increase its competitiveness and improve its infrastructure.

Introduction

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Many challenges must be addressed to enhance competitiveness and to attract additional FDI.

The most important data and comments about FDI evolution come from Romanian Agency for Foreign Investment (ARIS), Foreign Investors Council (FIC), National Bank of Romania (BNR), World Investment Report - United Nations Conference on Trade and Development (UNCTAD).

FDI flows to South-East Europe and the Commonwealth of Independent States

Global FDI inflows increased in 2006 to $1 306 billion – an expansion of 38% compared to 2005. This marked the third consecutive year of growth, and it reflected strong economic performance in many parts of the world. But, it didn't reach the previous record level of $1,411 billion in 2000.

Inflows increased in all three groups of economies:

-developed countries;

-developing countries,

-transition economies of South-East Europe and the Commonwealth of Independent States (CIS).

FDI inflows into South-East Europe and the CIS grew by 68%, to $69 billion – a significant leap from the inflows of the two previous years. As a result, the share of inward FDI in gross fixed capital formation rose from 16% in 2005 to 21% in 2006.

The top five recipient countries (the Russian Federation, Romania, Kazakhstan, Ukraine and Bulgaria in that order) accounted for 82% of the total inflows. Those to the Russian Federation almost doubled to $28.7 billion, while those to Romania and Bulgaria grew significantly, in anticipation of their accession to the EU on 1 January 2007 and due to a series of privatization deals (Table 1).

Virtually all of this outward FDI reflected the expansion abroad of Russian Transnational companies (TNC), especially some large resource-based firms seeking to become global players and some banks expanding into other CIS countries. While the services sector was particularly buoyant because of increased cross-border merger and acquisitions (M&A) in the banking industry, the primary sector received higher inflows as a result of soaring demand for natural resources.

Table 1

FDI inflows, by host region and major host economy, 2006 – 2007

Host region/economy	**Billions of dollars**		**Growth rate -%-**
	2006	**2007**	
World	**1 305.9**	**1 537.9**	**17.8**
Developed economies	***857.5***	***1 001.9***	***16.8***
European Union	*531.0*	*610.0*	*14.9*
-EU 15 (1995)	492.1	572.0	16.2
-EU 10 (2006)	38.9	38.0	- 2.3
United States	*175.4*	*192.9*	*10.0*
Japan	*-6,5*	*28,8*	...
Developing economies	***379.1***	***438.4***	***15.7***
Africa	*35.5*	*35.6*	*0.1*
Latin America and the Caribbean	*83.8*	*125.8*	*50.2*
Asia and Oceania	*259.8*	*277.0*	*6.6*
Transition economies	*69.3*	*97.6*	*40.8*
-Kazakhstan	6.1	8.3	34.4
-Romania	**11.4**	**9.0**	**-21.3**
-Russian Federation	28.7	48.9	70.3

Source: UNCTAD, http://www.unctad.org/en/docs/iteiiamisc20072_en.pdf

In some natural-resource-based economies of the CIS, such as the Russian Federation, the State continued to increase its control in strategic industries. At the same time, in countries of South-East Europe, FDI related policies continue to be in line with their accession or aspirations to accede to the EU, and with their aim to step up the privatization of State owned enterprises.

Developed countries were the main investors in the region's greenfield FDI projects. EU countries accounted for 70% of such projects, followed by the United States with 9%. The share of the Russian Federation as a source of greenfield FDI projects remained low (4%).

Romania was the second largest FDI recipient, with most of the $11.4 billion in 2006, worth of flows linked to privatization.

UNCTAD has a controversy attitude about the FDI related prospects into South-East Europe and the CIS and it offers a mixed prospect for 2008.

First, FDI inflows in the region are expected to be particularly buoyant in large economies such as the Russian Federation and Ukraine, as well as in the two new EU members (Bulgaria and Romania). The privatization of State-owned enterprises world is likely to boost FDI in South-East Europe.

Despite unfavorable economic growth projections and potential tightening of rules for foreign investment in resource extraction, strong demand for natural resources around the world is likely to boost FDI in the extractive industries in 2008.

At the same time, global external imbalances, sharp exchange-rate fluctuations, rising interest rates and increasing inflationary pressures, as well as high and volatile commodity prices, pose risks that may have a chilling effect on global FDI flows. Crossborder M&A activity already declined in the second half of 2007.

For example, in Romania, FDI inflows declined to $9 billion in 2007.

The overall level of FDI activity in 2008 therefore remains uncertain.

FDI flows in Romania – optimistic forecasts for 2008, but FDI decline in 2007

The Romanian Agency for Foreign Investments put foreign direct investments at 7 billion euros in 2008.

Continuing the trend of last year, ARIS expects a great share of FDI to come from significant Greenfield projects developed especially in sectors with high value added, but also from expansions and development of investors already present in Romania.

The sectors forecasted to be the prime destination for investment this year refers to automotive and automotive component parts, construction materials, wood processing, pharmaceuticals, consumer goods, and also electronics.

Another field of activity with high potential for investment is the service sector, and especially IT and telecommunication, banking and insurance.

Renewable energy represents a quite new domain for Romania, but lately it registered a spectacular positive trend driven by the European directives in the field that support the extensive use of green energy.

Sectors like retailing and real estate that experienced a real boom in the recent years will continue to be among the top preferences of the foreign investors.

Foreign direct investments attracted by Romania in 2006 hit a record level of 9.05 billion euros or $14.4 billions (BCR bank privatization is included), up 74% on the previous year.

Of this sum:

-4.159 billion euros accounted for stakes held in companies (46% of the total FDI);

-2.673 billion euros for reinvested net profit(30% of the total FDI);

-2.227 billion euros for net loans secured from foreign investors (24% of the total FDI).

Net FDI inflows in 2006 amounted to EUR 34,512 million, and consisted of the following:

-The foreign direct investors equity stakes in the share capital of direct investment enterprises in Romania worth EUR 27,016 million (78% of net FDI);

-The reinvested net earnings that stood at EUR 7,496 million (22 percent of net flow).

At the end of 2006, the volume of foreign direct investments reached 34.5 billion euros, around one third of the gross domestic product(GDP), with the sums destined primarily to the manufacturing industry (34.2% of the total) followed by financial services and insurance (22.2%).

From a territorial point of view, FDI went mainly to Bucharest-Ilfov region (64.3%), but other development regions benefit from no significant FDI inflows (Table 2).

Table 2

FDI distribution by development regions in 2006

Development region	**-%-**
TOTAL, *of which:*	**100**
Bucharest	64.3
South-East	7.7
South	6.5
Centre	7.4
West	5.6
North-West	4.6
South-West	2.7
North-East	1.2

Source: BNR, 2006

The FDI distribution by the 8 development regions in Romania offers information about the strong differences for the regional development, but from a profitability point of view, there is a FDI „congregation process“, because the foreign investors prefer a location which are already developed.

But, the value of foreign investments in Romania declined in the first 11 months of year 2007 by around 20% compared to 2006, to 6.6 billion euros. In the January - November period of 2006, the value of foreign capital stood at 8.3 billion euros.

As concerns the volume of FDI to be attracted in Romania for 2008, ARIS representatives consider FDI to reach EUR 7 billion, maintaining the level of inward investments in 2007- the first year of integration in the EU.

Romanian Progresses and Desiderates

Romania's economic growth has been strong and the business environment has improved significantly over recent years.

Driven by the goals of timely European Union membership, Romania has made significant progress with structural reforms in privatizations, banking, and enterprise restructuring. More 70% of economic activity is now in private hands, advanced price liberalization, an open foreign trade regime, and significant and ongoing advances in the opening of key markets such as energy and infrastructure. Romania also continues to improve legislation in the area of corporate governance, for example by introducing new mandatory voting requirements for publicly held companies.

Cumulative FDI between 1990 and 2005 has reached over $ 21.5 billion.

The Agency's mission (ARIS) is to be the Government leading body for providing consultative services to foreign investors that will attract, retain, and grow foreign direct investment in Romanian economy, as a result of a friendly and attractive business environment for developing investment projects.

ARIS offers to the foreign investors 10 major reasons to invest in Romania: great market potential, strategic location, significant natural resources, high skilled labor force, high potential for economic growth, new EU member, infrastructure growing steadily, friendly business environment, access to European funds, competitive taxation.

Briefly, when considering Romania as a possible location for developing their businesses, the foreign investors might benefit from the advantages offered by Romania:

-Market & Location Advantage, because it is one of the largest markets in Central and Eastern Europe (over 21 million inhabitants); it is an attractive location: allowing an easy access to the countries of the Balkans, to the Middle East and Northern Africa and to the Commonwealth of Independent States (CIS); it is an attractive location; at the junction of three prospective European transportation corridors no.4,7,9.

-Resource Advantage: Rich natural resources, including fertile agricultural land, oil and gas; skilled labor force, with solid knowledge in technology, IT and engineering; an important potential for tourism.

-Political Advantage: EU membership on January 2007, member and stability factor in the Area –NATO, Democratic political power, Stable executive power

-International Relations Advantage: Member of the UN and other international organizations, like: OSCE, Council of Europe and International Organization of La Francophonie, Bilateral diplomatic relations with over 177 countries, bilateral agreements between Romania and other countries for investments promotion and protection, free trade agreements with EU, EFTA countries, CEFTA countries, WTO member.

-Economical Advantage: sustainable economic growth, Functional Market Economy status, Decreasing inflation, Competitive tax policy: 16% flat tax; Permanent financial assistance for small and medium enterprises (SME); Development, increasing interest of Foreign Investors.

-Improving Infrastructure Advantage: Well-developed networks of mobile telecommunications in GSM systems, a highly developed industrial infrastructure, including oil and petrochemicals, the presence of branch offices and representatives of various well-known international banks, extensive maritime and river navigation facilities**,** a newly developed highway infrastructure, commitment to improve the highway infrastructure to EU standards.

-Social Advantage: Agreement between Government and Major Unions; No major Union Movements; Permanent dialogue with the employees associations ; Labor relations regulated by the Labor Code.

-Legislative Advantage: Legislation compatible with Acquis Communitarian; Similar legal provisions as in EU; Healthy fiscal policy regulated by the Fiscal Code

These advantages are not entirely valued either because of some internal factors or due to the concourse of European or international events.

Comparing performance and potential of the same countries, it can draw up a four-fold **matrix of inward FDI** performance and potential. In 2005, the size of the Romanian inward FDI was ***above potential***. (Table 3.)

Table 3

Matrix of inward FDI performance and potential in 2005

	High FDI performance	**Low FDI performance**
High FDI potential	**Front-runners** Azerbaijan, Bahamas, Bahrain, Belgium, Botswana, Brunei, Darussalam, Bulgaria, Chile, China, Croatia, Cyprus, Czech Republic, Dominican Republic, Estonia, Hong Kong(China), Hungary, Iceland, Israel, Jordan, Kazakhstan, Latvia, Lithuania, Luxembourg, Malaysia, Malta, Netherlands, Panama, Poland, Portugal, Qatar, Singapore, Slovakia, Thailand, Trinidad and Tobago, Ukraine, United Arab Emirates and United Kingdom.	**Below potential** Algeria, Argentina, Australia, Austria, Belarus, Brazil, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Islamic Republic of Iran, Italy, Japan, Kuwait, Libyan Arab Jamahiriya, Mexico, New Zealand, Norway, Oman, Republic of Korea, Russian Federation, Saudi Arabia, Slovenia, Spain, Sweden, Switzerland, Taiwan Province of China, Tunisia, Turkey, United States and Venezuela.
Low FDI potential	**Above potential** Albania, Angola, Armenia, Colombia, Congo, Costa Rica, Ecuador, Egypt, Ethiopia, Gabon, Gambia, Georgia, Guyana, Honduras, Jamaica, Kyrgyzstan, Lebanon, Mali, Mongolia, Morocco, Mozambique, Namibia, Nicaragua, Republic of Moldova, ***Romania,*** Sierra Leone, Sudan, Suriname, Tajikistan, Uganda, United Republic of Tanzania, Uruguay, Viet Nam and Zambia.	**Under-performers** Bangladesh, Benin, Bolivia, Burkina Faso, Cameroon, Democratic Republic of Congo, Côte d'Ivoire, El Salvador, Ghana, Guatemala, Guinea, Haiti, India, Indonesia, Kenya, TFYR of Macedonia, Madagascar, Malawi, Myanmar, Nepal, Niger, Nigeria, Pakistan, Papua New Guinea, Paraguay, Peru, Philippines, Rwanda, Senegal, South Africa, Sri Lanka, Syrian Arab Republic, Togo, Uzbekistan, Yemen and Zimbabwe.

Source: UNCTAD, http://www.unctad.org/en/docs/wir2007_en.pdf

Virtually, the size on the above potential shows the countries with low FDI potential but strong FDI performance.

The same time, the UNCTAD matrix considers that Romanian economy has less advantages than ARIS offers. Therefore, Romania is below potential wanted by foreign investors.

At the present, UNCTAD has a ranking of the latest year available 2004-2005 and is covering 141 economies. The potential index is based on 12 economic and policy variables, according to the UNCTAD methodology.

No country rankings under number 70 is considered to indicate a performing economy.

Romanian country rankings by Inward FDI Performance Index, Inward FDI Potential Index and Outward FDI Performance Index, 2004-2006 proves that our economy is under surveillance by the foreign investors (Table 4).

Table 4

Romania rankings by Inward FDI Performance Index, Inward FDI Potential Index and Outward FDI Performance Index, 2004-2006

Years \ Index	Romania rankings by:		
	Inward FDI Performance Index	Inward FDI Potential Index	Outward FDI Performance Index
2005	26		
2006	21		
2004		77	
2005		76	
2005			94
2006			98

Source: UNCTAD, World Investment Report 2007; www.unctad.org/wir or www.unctad.org/fdistatistics.

World Bank has another 10 indicators which form the ranking.

Conclusions

In the last years, Romania has become a more appealing target for an increasing number of foreign investors.

Romania offers to the foreign investors many major reasons to invest in Romania: great market potential, strategic location, significant natural resources, high skilled labor force, high potential for economic growth, new EU member, infrastructure growing steadily, friendly business environment, access to European funds, competitive taxation.

The UNCTAD Matrix of inward FDI performance and potential in 2005, consider that Romanian economy has a low potențial FDI, but above performance FDI, comparing the judgements of the foreign investors.

But much remains to be done.

The Foreign Investors Council (the FIC) from Romania believes that Romania must still improve the enforcement of new laws and regulations; tackle major social reforms, including reform of the labor market; increase its competitiveness and improve its infrastructure.

Efforts to ensure a stable and more transparent regulatory system must be increased. Reform of the public administration must advance more quickly and judicial reforms must be implemented more effectively.

Efforts to increase accountability must be intensified.

The environment is another major challenge the country continues to face. This includes air, water, and soil pollution; the non-efficient use of energy in domestic and industrial sectors.

As large-scale privatizations near completion, efforts must be made to attract more Greenfield foreign investment.

The success of such efforts will depend on Romania's ability to improve its investment climate and supply a skilled and competitive labor force within the tight framework of EU market rules.

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