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2006

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Abstract:

No country can develop without an active capital market, which has to be capable to meet the mobilization requests of the assets for financing the national economy. On the other hand, it has to be a profitable instrument for placing the available financing resources. The existence of a potential positive impact of the foreign investments on the competitivity of the receiving country is well known.

Starting from the above mentioned, in this paper, we intend to examine the way in which the foreign investment flow influences the performance of the economy and that of the Romanian capital market.

JEL Codes: G10, O0, E0
Key words: foreign investment, macroeconomic variables, GDP, capitalization

The globalization phenomenon of the economy, due to the competition growth and the impact of the new technologies generated at the national economy level, the occurrence of a new investment source, the international investments. The foreign investment as a capital contribution created by another economical system represents, in a neo-classical approach of the development phenomenon, a quite obvious urge to increase the GDP potential. So, the simple financing of an investment based on an external capital, is the hypothesis of development, not only through quantity and quality growth of the capital, but also through a better use of other available resources which remained unused.

In the past two decades, the development of the capital markets has become a priority in many developing countries, being an integral part in the economic reforming processes in which these countries engaged.

The failure of the anterior strategies, which ignored or minimized the role of the market mechanisms, contributed to the growing importance given, at the present moment, to the capital markets and to the understanding of the potential role of the private initiative and of the capital markets in economical growth. The experience of the developed countries reveals that the very existence of a mature capital market has created the premises, which contributed to the attracting of foreign investments of portfolio.

In this context, many countries have loosen their legal settlements, regarding the capital flows of portfolio, following the stimulation of the development of the national capital markets, the assuring of a better spreading of the risk and the mobilization of the supplementary external financial resources as well as the improvement of their structure.

Due to these changes, the portfolio flows have had an extraordinary boom during the 90's, being associated not only with the positive effects upon the economies that are passing through a development period, but also with the extreme profound financial crises from the last decade of the 20th millennium and even of the beginning of this millennium. From this dual perspective, the importance of reevaluating the benefits and portfolio investment costs from the point of view of the developing countries, and especially of Romania, as an ending point of these resources, is obvious.

As the capital markets are developing, specialized instruments and institutions appear, the investment opportunities diversify, all these aspects contributing to the growing of the saving and capital gathering rates[1].

Many studies[2] demonstrate that the development of the capital market is strongly connected to the current and future economic growth. The analysis of Errunza Vihang realized on a pattern of 32 developing countries, during the observation period 1981-1996, took into consideration the following indicators: the capitalization of the market as a percentage out of GDP, the transaction volume relative to GDP, the turnover, the number of companies listed and the real GDP growth.

The results of Errunza's analysis reflect that there is a significant correlation between the capitalization of the market relative to GDP and the transaction volume relative to GDP. (See table 1.)

Table no.1

Correlations indicators capital market– economic growth

	Capitalization /GDP	Turnover/GDP	Turnover	No. of traded companies
Capitalization /GDP				
Turnover/GDP	0,3515***			
Turnover	-0,0739	0,6839*		
No. of traded companies	0,0239	-0,0564	0,0319	
Real growth GDP	0,1491	0,4912*	0,5101**	0,1355

*, **, *** Significant statistic level of 1%, 5% and, respectively, 10%

Source: *Errunza, Vihang R.* – Foreign Portfolio Equity Investments in Economic Development - *SSRN, July 1999*

The capitalization of the market relative to GDP is insignificantly correlated to the turnover; the real growth of GDP is significantly correlated to the transaction volume, relative to GDP and, respectively to the turnover. Although there are for sure other factors with important effect regarding the economical growth, the correlation level obviously indicates an important positive connection.

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[1] *Errunza, Vihang R.* – Foreign Portfolio Equity Investments în Economic Development*, 1999*

[2] *King, R. şi Levine, R.* – Finance, Entrepreneurship and Growth – *1993; Atje R., Jonanovic B.* – Capital Markets and Development*, 1993*

Using a simple analysis proposed by Errunza in the case of Romania, it is obviously in table 2 that the most important correlation is between the capital exchange capitalization relative to GDP and the transaction volume relative to GDP. The real growth of GDP is significantly correlated with all considered variables, but there is still needed the isolation of other factors, which have impact upon the gross internal product (GDP) before reaching a conclusion upon the dimension of the impact of the exchange market's activity upon the economic development.

Table no.2

Correlations indicators capital market – economic growth in Romania

	Capitalization/ GDP	Turnover/GDP	Turnover	No. of traded companies
Capitalization /GDP				
Turnover/GDP	0,9562**			
Turnover	-0,1799	-0,3438*		
No. of traded companies	0,0651	0,1319	0,2755	
Real growth GDP	0,4103**	0,4654	-0,856	-0,4741**

*, **, *** Significant statistic level of 1%, 5% and, respectively, 10%

Source: *Calculi according to the data furnished by the Exchange Stock Market Bucharest and the National Institute of Statistics*

This analysis demonstrates that the capital market can play an important role in the economic development of a country. A functional capital market, can sustain the privatization process through the facilitating of the efficient and real evaluation of the state's assets as well as through the possibility of allotting these assets among the local and foreign investors.

The foreign portfolio investments appeared as a significant alternative with real attributes in the efficient diversity of the risk and the correlation of the fluxes, comprising either by direct acquiring of financial instruments from the local markets (stocks, public securities, bonds), either administrative investment like country funds.

The active participation of foreign investors gives a feeling of trust among the local investors. The market becomes more active and capable to support the new stocks emission, inclusively the privatization of the state owned companies. The capital market liberalization will represent a proof of the government's engagement regarding the implementation of reforms specific to the free market and will increase the overall credibility of governmental intentions and policies.

The corporatist control on the rising markets is at the beginning. Therefore, the portfolio foreign investments can play a disciplinary role in the markets by imposing managerial performance standards through the monitoring of the company's activities.

The foreign portfolio investments can also serve as an alternative to the financing of the external debt, thus contributing to the improvement of the condition quality and quantity of the loans on the international markets. If these resources complete and don't replace other forms of external financing or internal saving, they should determine the internal capitalization growing level both on a long and short period.

In Romania the impact of the portfolio investments on the capital market can have a positive effect, which aims the diversity of the financial transport, the banking transparency, and that of the information needed by the investors, the investor's protection, the growing of the investors' interest, of the capital exchange capitalization, as well as negative effects regarding mainly the due risk of such an investment type.

The limited diversity of the financial instruments by the Romanian capital exchanges has determined the attracting of a relatively reduced volume of the portfolio investments.

The experience reveals that the foreign investors complain about the Romanian capital exchange regarding the lack of derived products. As there is no possibility of doing *hedging*, protections against investment risk operations, these abstentions from institutional investors are well founded.

On the other hand, the special performances of BVB in the past two years (2003-2005) represent an attraction element for the foreign funds with high risk. Most of the foreign country funds which operate in Romania (Danube Fund, Romania Investment Fund, Broadhurst, Oresa Ventures, SEAF Trans-Balkan Romania Fund, Romanian Post Privatization Fund) are active not only on the private equity market but also on the regulated markets, a delimitation being very difficult to be done. Being under the influence of the quantification of the performances, the institutional investors act also as strategic investors and tactical investors according to the opportunities (so volatile) of the Romanian economy. Their investments, even if they were strategic at the beginning, have taken into consideration the tactical adaptation to the markets' evolution as well.

From the legal point of view regarding the foreign investors, as opposed to the native one, the Romanian law enforcer does not make a distinction on the capital market. Both are permitted to participate not only as natural persons but also as judicial persons to the financial instrumented operations.

The participation of the foreign capital to the Capital Exchange Bucharest, through the interacting of the decisional factors, has encouraged not only the development and creation of a frame specific to the dissemination of information at the transparency and accuracy standards, bringing them more and more closer to the international conditions.

The foreign investment portfolio flows increase the level of integration on markets, so that the unfavorable evolution on a capital market can affect other developing or developed markets, the macroeconomic conditions characteristic to each, being at least able to diminish the impact of the negative effects, and to amplify the impact of the positive ones.

A strong correlation is the premise of contaminating the markets during decreasing seasons – "bear market", the most eloquent examples being the impact of the crisis from the last decade of the last century not only on the rising markets but also on the developed markets.

A study realized by Stulz[3] regarding the effects of modification from a market, points out that: "if there is sufficient arbitrating capital, then the

[3] Stultz R. – International Portfolio Flows and Securities Markets, 1997

contamination should not be a problem". The lack of such a capital is the result of the organizing of the investment segment, of the problems of evaluating the performance and the lack of some types of investors, like the risk capital funds.

The association of the capital flows fluctuations with the liberalization of capitals is rather empirical. The instability or fragility of the capital market is rather the result of the institutional structure changes, because there are no proofs, which may lead to the confirmation that the portfolio investments are rather instable than other external financing sources

All these sustain the fact that the simple presence of portfolio investments does not imply a segmenting of the local capital market, just like their elimination does not necessary lead to the increasing of the markets' integration degree. So, in the reforming process of the capital market in Romania and of the portfolio investment regime, one must take into account the preconditions of the market opening, to set the reforms' sequence and its settlement.

A relatively gradual transition towards the market economy and the choosing of some measure in order to reduce uncertainty instead of controlling the capital, represent the healthy premises for those emerging markets which desire to minimize the too high variation of the all kinds of capital flows. As well, some measures must be taken into consideration for safe settlement in order to improve the market deficiencies. The infrastructure must include institutions for settling and surveying which are politically independent, have recognized and internationally appreciated accounting standards, well defined property rights, an efficient legal system with a good reputation, corresponding, qualified and trustworthy personnel. The lack of adequate and correct information brings asymmetries, which offer unjustified advantages to the investors with access to supplementary information, thus undermining the trust in market.

The implementation of all these measurement that lead to an opening towards the international capitals must be sequent ional and must depend on the development level of the respective country.

As a conclusion, the exact succession – or the lack of a succession – will depend on the local and global circumstances.

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