Oana Simona HUDEA
University of Bucharest, Romania

FOREIGN DIRECT INVESTMENTS – HOW MUCH YOU CAN GET

Review Article

Keywords
Foreign direct investments,
Equity,
Investment shares,
FDI benefits and shortcomings,
Direct investment enterprise

JEL Classification
E22, F21, P33, P45

Abstract

Frequently debated topic, the issue of foreign direct investments has generated miscellaneous discussions related to the benefits they can provide to an economy, depending on the size, strength, strategy or position of the same, among many other aspects to be considered, however without skipping on the undesirable effects they might cause. With this in mind, we undertook to reveal in the present paper, after a brief clarification of some key related elements in the matter, indices of the advantages and disadvantages they can bring to a still developing country like Romania, the economy of which is analysed in larger detail, from such perspective.

INTRODUCTION

The Foreign Direct Investments (FDI) topic, increasingly approached in our times, by statisticians trying to gather, to process and to provide, directly or indirectly, pertinent data to those interested in using them in thorough studies or to decision power authorities, by academic researchers aiming at revealing the main causes and effects of the same and, very often, at analysing them at macro level in terms of past evolutionary trends and forecasts, therefore offering useful information to the scientific environment, or by entitled institutions, fiscal or monetary organisms, endeavouring to capture, by resorting to their internal intellectual resources, undistorted content, tremendous important in a well-grounded decision-making process, has generated an impressive range of opinions and results, not always convergent, but, all of them, directed towards the setting of a coherent pattern in the matter, allowing for a subsequent consistent development thereof.
Considering the various offering perspectives of analysis raised by such topic, previously approached by the author in several respects (Hudea, 2011, 2012a or 2012b), we decided to focus herein on some strictly theoretical issues, mainly related to positive and negative effects produced by the same on the economic life, going from general items to particular ones, for finally targeting the FDI consequences on the Romanian economy.
The structure of the paper is as follows: section 2 reveals Key issues about Foreign Direct Investments, section 3 renders the main Benefits and shortcomings caused by Foreign Direct Investments, while section 4 stops a little bit for analysing The case of Romania from the perspective of Foreign Direct Investments.
The paper ends with Conclusions, summarising the most important aspects of the above-mentioned study.

KEY ISSUES ABOUT FOREIGN DIRECT INVESTMENTS

Given the popularity of Foreign Direct Investments, both as a concept and as a mean for bringing an economy to a new development stage, the trials of correctly and comprehensively defining the same have resulted in outlining a series of largely accepted features, mentioned hereinafter.
Foreign Direct Investments represent the investment relationship established, in the long run, between a resident entity and a non-resident one, the last specified having a certain level of managerial control over the enterprise it has directly vested in. (The National Bank of Romania, 2016)
Two important institutions, the International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD) consider that Foreign Direct Investments are investments made by an individual or group of individuals, by a public or private enterprise or a group of public or private enterprises, or by the Government in a company operating in a foreign country, the former holding, in term of ordinary shares and right to vote, at least 10% of the latter, this percent ranging between 10% and 50% for associates, exceeding 50% for subsidiaries and going up to 100%, in the case of branches. A mention to be made concerns the fact that such thresholds and other related conditions and restrictions highly depend on the national regulations of the direct investment target country (Duce, 2003).
Going into larger detail, according to the information provided by the National Bank of Romania (2017), Foreign Direct Investments reflect transactions or positions of equity and investment fund shares or units, including reinvestment of earnings, on one hand, and debt related instruments, on the other hand, between the target country enterprise and the direct investment initiating entity, mainly determined by resorting to the directional principle, the related data being processed based on the last international statistical standards (IMF, 2009)

BENEFITS AND SHORTCOMINGS CAUSED BY FOREIGN DIRECT INVESTMENTS

In order to clearly render the advantages and disadvantages brought by Foreign Direct Investments, we will proceed hereinafter to a structuring of the same considering the criterion of the specific target item affected by the FDI effects, namely the target direct investment enterprise, that is the enterprise in which the foreign direct investment is made, sometimes internationally designated as multinational enterprise or corporation (simply called, from now on, *target direct investment enterprise*), and the target direct investment country, more exactly the country where the direct investment inflow at enterprise level is registered (identified, in the paper, as *target direct investment country*).
The advantages/disadvantages of Foreign Direct Investments for the target direct investment enterprise are obviously more visible, with a quicker and higher consistent impact than the ones observed as for the target direct investment country, the latter benefiting indirectly, to a different extent, by the same.

Thus, the target direct investment enterprise can take advantage of the knowledge, informational package, efficient practices, experience, or technology, among many others, acquired via such investment, therefore increasing its competitive advantage.

If we want to go forward and consider that the products resulting from the activity of the direct investment enterprise could be destined not only to the domestic market, but also exported abroad, the fact that we deal with a certain mix of cultures, traditions, perspectives, attitudes, manners of thinking and acting and so on, as we talk about individuals originating in, at least, two nations, can turn into benefits, such products incorporating features that will make them better fit for a larger range of customers.

The production cost is, without any doubt, a tremendous important issue for the success of a company on the market, Foreign Direct Investments being more effective if associated with lower levels of the former.

Achieving this involves either resorting to cheaper resources of any kind, however without diminishing their qualitative level, or raising the efficiency in using such resources, transformed, in the production process, into production factors, this being usually translated into the increase of the labour productivity…or, better, both. If the price of resources highly depends on the characteristics of the target direct investment country, the labour productivity rather relates to the capacity of the domestic and foreign main actors to act into the right direction in terms of efficiency.

However, the target direct investment enterprise might be placed in the position of confronting with an unstable and, sometimes, highly unpredictable macroenvironment, be it economic, social, political or otherwise in nature (Grimsley, 2017), the favourable effects that might be generated by Foreign Direct Investments being annihilated by such circumstances that impede the target direct investment enterprise to act, at its potential, on the related market.

Yet, if the target direct investment enterprise succeeds in effectively using the market of the target direct investment country and, on the grounds thereof, in developing itself in terms if size and efficiency, it might create the premises for rolling benefits, among others in terms of advantageous collateral-based loans. This, on the other hand can turn into disadvantages for the target direct investment country, if such borrowed funds are directed towards the foreign direct investment origin country and not towards the direct investment enterprise, for reinvestment purposes (Loungani, and Razin, 2001).

As concerns the target direct investment country, the best advantages are got when this one is an emerging or a developing country, as it can get more of the overall technology, know-how and expertise coming from a more developed one, this allowing it to direct towards an increased, accelerated progress and, in consequence, to an augmented general welfare.

Besides, as the target direct investment enterprise evolves, both horizontally and vertically or, otherwise said, both extensively and intensively, the target direct investment country takes advantage from a double perspective: the one related to the increase of the demand for labour force, leading, as result of the compatibility between the associated demand and supply, to the decrease of the unemployment rate, on one hand, and the one related to the increased volume of taxes and fees paid by the same to the state budget, therefore, to a higher level of public revenues, on the other hand.

More than that, the above-mentioned two benefits can be indirectly achieved by a target direct investment country, the newly established businesses, aiming at providing such direct investment enterprises with the necessary inputs, being in the position to generate more available jobs for the domestic population and more money to the state budget (Grimsley, 2017), with all subsequent positive effects.

It is very clear that, more developed a country, less tempting for foreign entities to directly invest in, when considering the labour force which is more expensive, people certainly better knowing their rights emerging from a more strict, non-permissive legislation, set up for the purpose of protecting the resident population.

When directly investing in a foreign country, there is also a problem when coming about using domestic natural resources or capital resources if their prices are above the efficiency-related maximum accepted threshold.

Therefore, in terms of expenses arising from the use of all sorts of traditional production factors (labour factor, land factor and capital factor), Foreign Direct Investments are more “productive” if oriented towards less developed countries as, overall, the related production cost will decrease, allowing for a more consistent profit margin, and thereby, am increasingly significant return on investments.

If this is a good thing, for both, the target direct investment enterprise and, indirectly, for the target direct investment country, the entitled authorities of some, usually poorer, emerging or developing countries, should pay attention to the evolutionary impact of Foreign Direct Investments, keeping in mind that the domestic population is much more subject to “exploitation”, the related organisms having to implement, as the case may be, protective laws in the matter.

Instead, directly investing in a developed country certainly generates some distinct benefits, like the access to a stronger and stable market (laying the grounds for reasonable or even significant profits, given the sometimes higher level of prices) or the access to more qualitative production factors of any type, both traditional and neo-factors (management abilities, information and knowledge, technology etc), generating, as a consequence thereof, more qualitative products, be they goods or services.
In fact, Foreign Direct Investments targeting a developed country consist, the most often, in mergers or acquisitions of companies having reached a maturity stage, with the aim of either restructuring or rethinking, in term of focussing, on their core business (Amadeo, 2017)
Yet, irrespective if we are talking about an emerging, developing or developed target direct investment country, no nation should allow for the interference of foreign entities, not even via Foreign Direct Investments, with the said country interests.
In this respect, the level of Foreign Direct Investment inflows should be restricted, up to prohibition, as concerns certain industries, strategic areas and any other contexts that might cause the decrease of the comparative advantage of the related target direct investment country, or as concern the circumstances determining the inhibition of the domestic investments, the endangering of the domestic companies, or the decrease of the well-being level of the domestic population, which could bring, beyond certain benefits, higher negative effects on the country towards which Foreign Direct Investments are directed.

THE CASE OF ROMANIA FROM THE PERSPECTIVE OF FOREIGN DIRECT INVESTMENTS

In Romania, the post-communist evolution of Foreign Direct Investments has registered imperceptible levels in its incipient phases, due to the difficult position of our country, having to face a heavy process for turning itself into a market economy. However, once it has started to strengthen such position, the volume of Foreign Direct Investments inflow has progressively increased, a favourable ground being laid for foreign individuals or enterprises to see in our country a potential business partner.
This was largely due to the fact that, becoming a developing country, on one hand, it succeeded in providing tempting cost-effective contexts, the level of prices for the necessary production factors being significantly lower than in other, more developed countries and, on the other hand, it made steps in generating reasonable business contexts, considering the existing microeconomic environment, with an impressive number of qualified people willing to work for such target direct investments enterprises, with suppliers ready to provide inputs to the same enterprises, often with low or even inexistent direct competitors or, at least, with low or even inexistent powerful competitors, depending on the enterprise field of activity, and, more important, with an increasing consumption appetite of the domestic population (leaving aside the infrastructure or bureaucracy related serious problems – important aspects to be considered for attracting foreign funds).
Somehow unpredictable, things have suddenly evolved, the previously mentioned aggregate consumption reaching unexpected high levels, element extremely important in generating an increase of the foreign direct investment level.
The economy was passing through an overheating phenomenon (mainly fed by a series of domestic credits granted without real covering) which, after a moderate period of economic boom, turned, as expected, considering the economic cyclicity, into an economic decline and, subsequently, after two consecutive quarters of negative economic growth rate, into recession. Therefore, the unfavourable national conditions, certainly doubled by the external pressure (several foreign economies already facing serious economic problems), made Romania enter, too, into a period of economic crisis.
Obviously, after a flowering period for Foreign Direct Investments, the end of 2008 (the beginning of the economic crisis in our country) marked a visible descending trend of the same, due to several important aspects, such as the fact that the foreign investing entities had more or less serious financial problems, that business-associated risks were increased in those times-related circumstances, that the domestic population was unable, financially, to maintain consumption close to its previous levels or was not willing to do so, trying to have some reserves, and so on.
After a significant drop-down of Foreign Direct Investments in Romania, the same started a slow recovery process in 2012, once the economic crisis was over, ascension continuing also at this paper drawing up date.
In order to graphically reveal the beneficial aspects that such investments had on the Romanian economy, we presented in *Figure 1*, below, not the level of Foreign Direct Investments in absolute terms, but the Foreign Direct Investments - Gross Domestic Product (GDP) ratio, expressed in percents. Thus, we succeeded in showing, simultaneously, that the periods of economic growth basically coincide with those periods when the ratio of Foreign Direct Investments in Gross Domestic Product was higher, therefore suggesting that, overall, Foreign Direct Investments are,

indeed, or, at least, have been, until nowadays, a source of economic growth for Romania.

CONCLUSIONS

In this paper, we undertook, after a brief rendering of several basic features of Foreign Direct Investments, to outline some of the most important advantages and, here and there, disadvantages generated by the same and, finally, to extend the analysis, showing how a concrete economy, namely the Romanian economy, has been affected thereby.

From an overall perspective, save for some negative effects that Foreign Direct Investments might cause to the foreign investing entity (basically associated with the direct foreign investment risk related to the target country micro and macro-environment), on one hand, and either to the target direct investment enterprise (mainly consisting in the exploitation of the company employees) or to the target direct investment country (such as the funds advantageously borrowed therein and directed towards the parent company, instead of being reinvested in the said target direct investment enterprise), on the other hand, we could identify a significantly larger rage of positive effects, aspect also confirmed by the Romania-related case study, benefits converging, altogether, towards a more stable and sustainable economic growth for the target direct investment country and for the well-being of its population.

REFERENCES

[1] Amadeo, K. (2017). Foreign Direct Investment: Pros, Cons and Importance, retrieved from https://www.thebalance.com/foreign-direct-investment-fdi-pros-cons-and-importance-3306283.

[2] Duce, M. (2003). Definitions of Foreign Direct Investment: A Methodological *Note, BIS Meeting of the CGFS Working Group, Banco de Espana*.

[3] Grimsley, S. (2017) What Is Foreign Direct Investment? - Definition, Advantages & Disadvantages, retrieved from http://study.com/ academy/ lesson/what-is-foreign-direct-investment-definition-advantages-disadvantages.html.

[4] Hudea (Caraman), O.S. (2011). Technology Spillover, Absorptive Capacity and Long-Term Development in the European Union, *Studii şi Cercetari de Calcul Economic şi Cibernetică Economică Journal, 45*(3-4), 1-9.

[5] Hudea (Caraman), O.S.; Stancu, S. (2012). Foreign Direct Investments - A Force Driving to Economic Growth, *Economic Computation and Economic Cybernetics Studies and Research, 46*(2), 105-126.

[6] Hudea (Caraman), O.S., Stancu, S. (2012). Foreign Direct Investments, Technology Transfer and Economic Growth. A Panel Approach, *Romanian Journal of Economic Forecasting*, *15*(2), 82-102.

[7] Loungani, P., & Razin, A. (2001). How Beneficial is Foreign Direct Investment for Developing Country, *IMF Finance and Development Magazine, 38*(2), retrieved from http://www.imf.org/external/pubs/ft/fandd/200 1/06/loungani.htm.

[8] International Monetary Fund (2009). *Balance of Payments and International Investment Position Manual*, 6th edition, BPM6.

[9] National Bank of Romania (2016). Foreign Direct Investment in Romania in 2015, *Statistics Department of the National Bank of Romania*.

[10] National Bank of Romania (2017). Direct investment - directional principle, retrieved from http://www.bnro.ro/Direct-investment---directional -principle-12352.aspx.

[11] 17 Big Advantages and Disadvantages of Foreign Direct Investment**,** retrieved from http:// connectusfund.org/17-big-advantages-and-disadvan tages-of-foreign-direct-investment, on June 24th, 2017.

[12] Eurostat Database, retrieved from http://ec. europa.eu/eurostat/tgm/table.do?tab=table&init =1&language=en&pcode=tipsbp90&plugin=1, on June 23rd, 2017.

ANNEXES

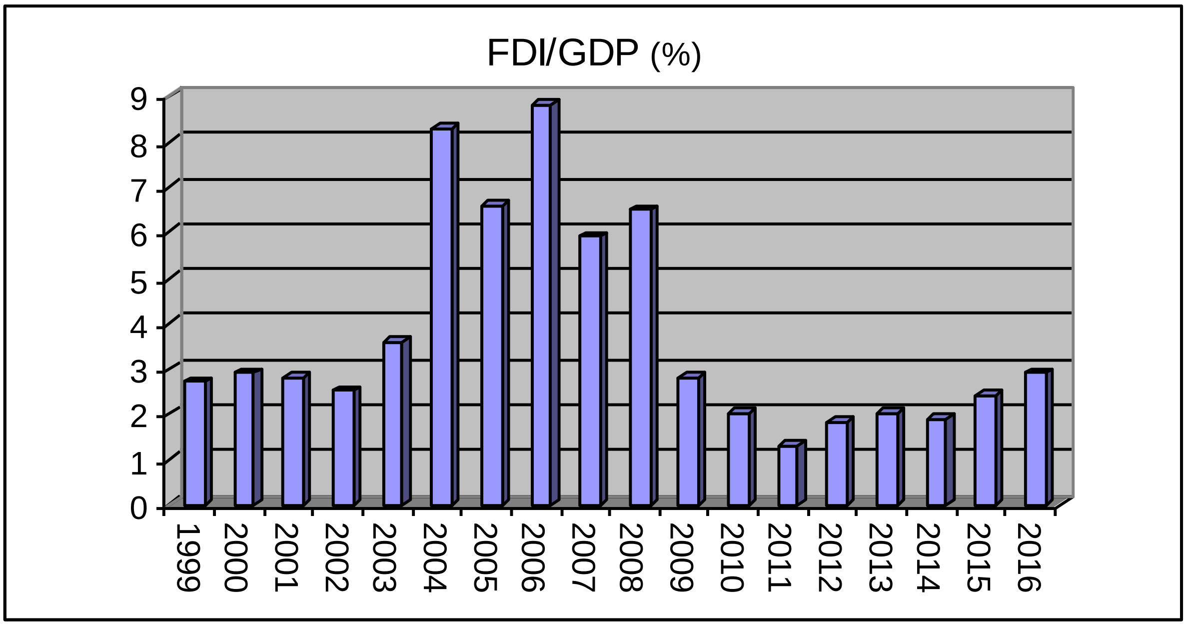

Figure 1. *FDI to GDP ratio, expressed in percents*
Source: Author's representation, based on Eurostat data