SEA - Practical Application of Science
Volume I, Issue 1 (1), 2013

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EFFECTS AND EVOLUTION OF FOREIGN DIRECT INVESTMENTS ON THE EMERGENT ECONOMIES

Keywords
Foreign direct investments
Economic growth
Integration
Globalization
European Union

JEL Classification
E40, E42, E59

Abstract

FDIs have also entailed a series of political implications in addition to the economic effects, especially in the context of the accession of Central and Eastern European countries to the European Union.

According to the specialists, for a given country, intense growth periods are characterized by the attraction of important flows of foreign direct investments (Lipsey, 2000, page 72). Although Romania has experienced high economic growth rates, it was not supported to the same degree by foreign direct investments.

For the countries with developing or in transition economies, these resources can not be provided from the domestic economy, and therefore, these states elaborate their policies to attract foreign investors capable to provide the best possible investment structure.

INTRODUCTION

The accession of Romania to the European Union brought the possibility of free movement of persons, services, goods and capital but also of attracting foreign direct investments totaling 44 billion euros. The economic implications of foreign direct investments on emergent economies can be traced at micro and macro-economic level.

FDIs have also entailed a series of political implications in addition to the economic effects, especially in the context of the accession of Central and Eastern European countries to the European Union.

According to the specialists, for a given country, intense growth periods are characterized by the attraction of important flows of foreign direct investments (Lipsey, 2000, page 72). Although Romania has experienced high economic growth rates, it was not supported to the same degree by foreign direct investments.

In 2005, the share of foreign direct investments stock in GDP represented 24.2%, which is below the European average UE-25 (31.7%).

Accordingly, in the context globalization and economic integration embodied mainly in the internationalization of production, foreign investments support economic growth in a higher or lower degree, depending on the specific conditions existent in each country. At the macro-economic level foreign direct investments generate both positive and negative effects[1]. From a conceptual point of view, positive implications at the macro-economic level refer to the following aspects:

- They support the economic growth, which is done differently depending on the form foreign direct investment takes.
- They stimulate domestic investments, as domestic producers will be interested in increasing the efficiency of the activity and improving the quality of outputs either to meet the competition due to the presence of foreign investors in the sector, or to acquire the status of suppliers for the foreign investor.
- They support restructuring and privatization, an aspect which is particularly important in the case of Central and Eastern European states, especially for the companies that require large amounts of capital and the ability to reorganize and leverage the economic activity.
- They generate positive effects on trade balance, if the direct investor produces primarily for export or in the case of the production intended for the domestic market which substitutes imports.

Although foreign direct investments can generate a series of positive effects at the level of location country, the possibility to appear a negative impact both at the macro-economic level and at the sectoral level is not excluded.

- Increase of unemployment due to restructuring of privatized enterprises in order to improve quickly the activity.
- Increase of imports, reflected negatively on the balance of trade balance, is due to the import of machinery and equipment financed by the foreign investor, without which the implementation of the investment would not be possible.
- Negative impact on the budget due, on one hand, to tax privileges granted to foreign investors, which have the immediate effect of reducing budget incomes.
- The increase of the number of unemployed people as a result of privatization and restructuring of state enterprises generates additional budget expenses, since the labor force laid off by restructured sectors is not immediately absorbed in developing activities.

Therefore, the impact of FDIs on host country economy differs from country to country, depending on the tangible conditions existing at the economic, social and political level and on the intake degree of foreign capital.

Foreign investment has been the key engine of Romania’s development strategy, in which the proposed objectives and challenges have taken a different dimension with perspective of integration in the European Union.

European integration was the main political objective of all political parties in power, fact which was confirmed by the completion of accession negotiations of Romania and Bulgaria to the EU at the summit in Brussels on December 16-17, 2004.

Upon the completion of accession negotiations, Romania has entered a new phase, in which Romanian economy had to reaffirm its active participation potential to achieve economic convergence with the European

[1] Viorela Beatice Iacovoiu -“Foreign direct investments between theory and economic practice” Editura ASE Bucharest, 2009

Union, in relation to the development strategies adopted by its decision-making structures. Romania's preparation for the accession to the European Union and the attraction of foreign direct investments allowed a positive economic evolution. Investments had a steadily increase especially during the pre-accession period in 2005 being maintained at a high level of 6.6% of GDP.

By joining the European Union, Romania has increased its degree of attractiveness as a destination country for foreign direct investments, especially in relation to the investors coming from EU countries.

Evolution of foreign direct investments attracted by Romania, period 2004-2011

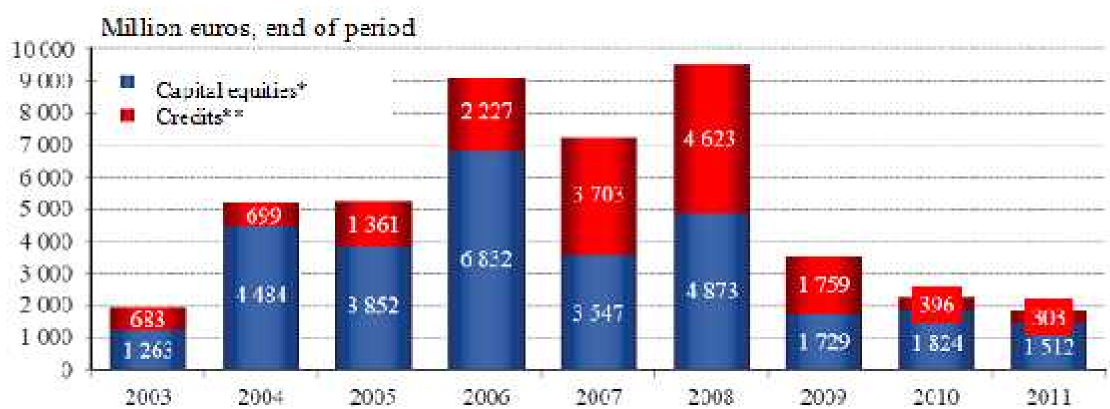
Val FDIs - Million EUROS

183 213 056 250 496 490 220 815

Source: National Bank of Romania, Balance of payments

Foreign direct investments in Romania increased progressively thus, while in 2004 foreign direct investments were only to a total value of 5183 million euros, the figure reached in 2008 to 9496 million euros. Romania passed in early 2003s through economic and political changes aimed at establishing free market economy, through the privatization of state-owned enterprises and deregulation of the economy. The results were immediate: domestic demand began to recover, inflation decreased, confidence in the market improved, external position was further strengthened.

Evolution of Fdis Flows During the Period 2003-2011



*net credits from foreign direct investors

	2003	2004	2005	2006	2007	2008	2009	2010	2011
FDI flows – total Million euros Percentage variation in relation to previous year	1946 60.6	5183 166.3	5213 0.6	9059 73.8	7250 20.0	9496 31.0	3488 63.3	2220 36.4	1815 18.2
FDI flows without significant privatizations** Million euros Percentage variation in relation to previous year	1805 48.9	3503 94.1	4413 26.0	6860 55.4	7250 5.7	8623 18.9	3488 59.6	2220 36.4	1815 18.2

**over 10 million euros

Source: National Bank of Romania, National Institute of Statistics "Foreign Direct Investments in Romania in 2011"

FDIs started to grow since 2003 from 1946 million euros reaching to a maximum of 9,496 million euros in 2008, and in 2011 decreased to 1,815 million euros.

In 2004 FDIs increased due to the Romania's accession to NATO, thus increasing investors' confidence level on the country. Investments in fields such as processing, trade and services increased.

In 2005 flat income tax was adopted, which attracted foreign direct investments, observing a significant increase in 2006 of 9059 million euros. This increase was also due to the privatization of the largest bank in Romania: BCR, the state obtaining 2.2 billion euros for 37% of the shares.

In the period 2005-2008, due to the strengthening of privatization process, foreign direct investments increased, registering unprecedented levels. On-coming of the accession to the European Union led to the increase of foreign investors' confidence and to a strengthening of economic growth which led to a greater attractiveness for foreign investors.

Net equities of foreign direct investors to the capital of the enterprises with foreign direct investment in Romania has to a total value of 1 512 million euros (83.3 percent of FDI net flow). Net equities to the capital result from the decrease of capital equities, amounting to 4 009 million euros, with a net loss amounting to 2 497 million euros. The net loss resulted from the decrease in the net profit of FDI enterprises in 2011 to a total value of 4 710 million euros of the dividends distributed in 2011 to a total value of 2 075 million euros, after which this value was reduced by the losses of FDI enterprises in 2011 to a total value of 5 132 million euros.

Evolution of FDI Balance in the Period 2003-2011

The calculation is in accordance with the international methodology for determining reinvested profit by FDI enterprises, the net loss registered by them respectively.

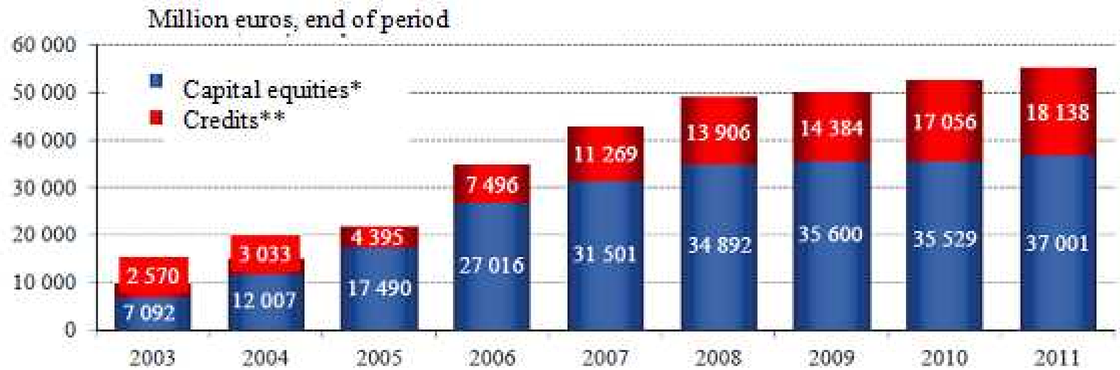
But the five years of sustained growth of foreign direct investments have ended with 2008. The causes of the decrease of FDI flows are:

- The increase of risk premiums, in the context of unfavorable perspectives regarding economic growth;
- Focus on FDIs in sectors strongly affected by the economic crisis – real estate transactions, automobile industry, metallurgy;
- The trend of significant increase of labor force costs by 2008.

Romania remains consistent with European trends, except that the maximum level of FDIs was reached in 2008 (9496 million euros). The reduction with over 65% of FDIs in Romania in 2009 confirms the existence of a gap at the level of economic cycles between developed countries and those in transition in Europe, as it has also happened in the case of the impact moment of the financial crisis.

In 2010, the level of FDIs only reached 2220 million euros, less than one third compared to the level registered two years ago. But the government tried to countervail the negative evolutions and to revive the appetite for investments in Romania.

Therefore, in 2010, state aids of 214.5 million euros were granted, which financed 10 investment projects to a total value of 711.7 million euros. The projects target different areas, which led to the creation of over 4,700 new jobs.



End of period

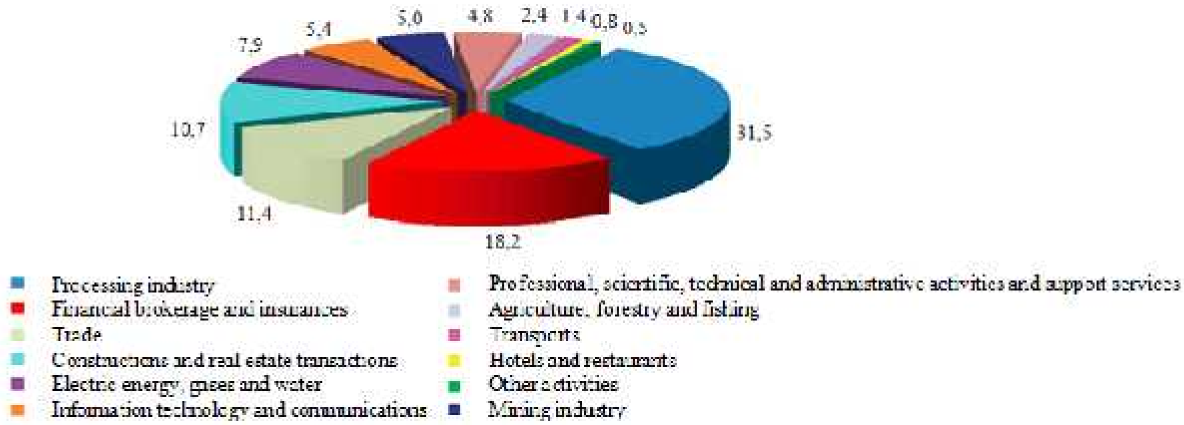
	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total Million euros Percentage variation in relation to previous year	9662 …	15040 55.7	21885 45.5	34512 57.7	42770 23.9	48798 14.1	49984 2.4	52585 5.2	55139 4.9
Capital equities (including reinvested profits*) Million euros Percentage variation in relation to previous year	7092 …	12007 69.3	17490 45.7	27016 54.5	31501 16.6	34892 10.8	35600 2.0	35529 -0.2	37001 4.1
Credits** Million euros Percentage variation in relation to previous year	2570 ..	3033 18.0	4395 44.9	7496 70.6	11269 50.3	13906 23.4	14384 3.4	17056 18.6	18138 6.3

*capital equities are consolidated with net loss
**net credits from foreign direct investors

Source: National Bank of Romania, National Institute of Statistics "Foreign Direct Investments in Romania in 2011"

The final balance of FDIs on December 31st, 2011 registered the level of 55 139 million euros, 4.9 percent higher compared to the final balance of FDIs in 2010. This result was obtained by adding to the initial balance of net flow of FDIs the positive/negative value differences resulted both from the reevaluations due to exchange rate modification and the price of certain assets and from accounting re-treatment of the value of initial balances of some reporting enterprises.

FDI Balance on December 31st, 2011
Distribution on main economic activities
Total economy (55 139 million euros)
Percentages



Source: National Bank of Romania, National Institute of Statistics "Foreign Direct Investments in Romania in 2011"

The equities in the corporate funds (including reinvested profit) of the enterprises with foreign direct investment had at the end of 2011 the value of 37 001 million euros (67.0 percent of the final balance of FDI), and the total net credit received by them from foreign direct investors, including within the group, recorded the level of 18 138 million euros, representing 33.0 percent of the final balance of FDI. Net credit includes medium-term and long-term credits, and also those on short-term given by foreign investors to their enterprises in Romania, both directly and by means of other non-resident companies that are members of the group.

In Romania, the contribution of foreign investments to the economic increase, particularly the multinationals, distinguished itself on the three main segments: balance of payments, employment and economic growth.

The analysis of FDI impact on the balance of payments must consider both trade flows (trade balance) and "the possible significant capital outflows or the diversion of certain potential flows on the part of other investors" (Dăianu & Vrânceanu, 2002, page 188). In this sense, the best example is the case of fixed telephony company Romtelecom, to whose privatization the foreign investor was guaranteed the monopoly on the market for the duration of 5 years (1998-2003), during which the tariffs increased significantly. These higher profits obtained as a result of anti-competitive techniques can turn into capital outflows as excessive salaries of expatriates and high royalty fees, negatively influencing the balance of payments. For the countries in transition to market economy, such situations are not unique, if we consider the concentration of FDIs on oligopoly markets[2].

The effects of foreign direct investments on local labor force depend substantially on the following factors: the size and type of investments; the foreign investor's input method; the targeted field; the strategy of investing companies; the specific conditions in the host country.

Bidirectional relationship between foreign direct investments and economic growth is due, on one hand, to their impact on the economic environment of each country and, on the other hand, to the positive influences which the sustained and durable economic growth has on received foreign capital flows.

In this context, the level of foreign money attracted by each state of the world will depend primarily on the global economic context and secondly on the attractiveness of the respective country. As about the first idea we can not influence things, here are five of the most important measures the Romanian state can adopt in the second one:

[2] Viorela Beatice Iacovoiu -"Foreign direct investments between theory and economic practice" Editura ASE Bucharest, 2009

1. Increasing climate of trust. The most important measure the state can adopt for the increase of foreign investments is to improve the climate of trust. The second step is to improve the communication of Romania's strengths. As we know, Romania has price stability and a financial stability, things rarely met in the same time, in the same state, in the same period and in addition, our country has only an economic crisis, not the financial crisis, too.

2. Change of investment law. Romania should modify investment law, remained unchanged for many years. Legislation should be made more attractive and stimulating for outside companies. Foreign investors should be given more financial facilities, access to utilities, simplified procedures, so as to find better conditions than in other parts.

3. Improvement of infrastructure;

4. Reduction of labor fiscality. Even if we still have cheap labor force, Romania is one of the states with the highest fiscality in this field.

5. Operationalization of public-private partnership. The terms of establishing public-private partnership represent a fundamental factor in attracting foreign investments. These should be changed so that "the state also takes risks, not only the companies".

Investing involves the mobilization and putting into circulation of important productive resources in a structure very different in nature and size, as capital, high techniques and technologies, organizational and managerial competences[3].

For the countries with developing or in transition economies, these resources can not be provided from the domestic economy, and therefore, these states elaborate their policies to attract foreign investors capable to provide the best possible investment structure.

In this sense an increase in the share of extra national participation companies to the creation of added value within the national economies, as well as an increase of the number of jobs, internal financial resources, are observed.

[3] Florin Bonciu , "Foreign direct investments and new global economic order", Editura Universitara, 2009, p.97

Their predominantly positive role from the economic perspective makes their presence predominantly beneficial for most people in host countries.

CONCLUSIONS

Foreign direct investments, as in the case of other economic activities, have suffered dramatic changes due to the economic and financial crisis started in 2008. The unusual development of the crisis had an unfavorable impact on the trend and capacity of transnational companies to make foreign investments and to expand abroad. The decrease in profits, reduced access to financial resources and commodity markets were some of the causes which led to the diminution of foreign direct investment flows. Also, another reason was the increased risk caused by a possible worsening of the crisis. Emergent companies that are "based" on these international investments for the economic development and creation of new jobs are primarily preoccupied by the decrease of these foreign direct investment flows.

According to World Economic Situation and Prospects 2012 (WEPS 2012) world economy is "on the edge of abyss" heading for a major decline. The problems pursued are many and interconnected. The most problematic issues are those related to the lack of jobs and the prospects of negative economic growth, especially in developed countries.

Economic instability is both a cause and an effect of debt crisis sovereign in euro area, but also of the crisis related to tax system. Sovereign debt crisis worsened in 2011 leading also to instability in the banking system.

Bold measures, undertaken by the governments of the countries in euro area to reduce Greece's debts, were not sufficient to restore the financial stability in the area, one of the largest economies in the European Union being on the brink of collapse (Italy).

Austerity measures were insufficient, leading further to negative economic growth and reducing the number of jobs.

European Union and the United States of America form the largest economies in the world, being deeply interconnected. Both also face high unemployment rate, with an unstable business environment and with the fragility of the financial system. Developing countries that are in process of recovery after 2009 recession could be hit by these problems through international trade, but also through financial channels.

Despite these unfavorable aspects, at the level of transnational companies there is some optimism. According to a survey conducted by UNCTAD (World Investment Prospects Survey 2010-2012)[4] 36% of the respondents expressed their optimism with regard to business environment.

Also the replies of investment promotion agencies are positive about the evolution of foreign direct investment flows for the next three years. Similar to transnational companies, investment promotion agencies tend to be more optimistic regarding the prospects for their country than the prospects for global investments.

Also the opinions of investment promotion agencies are optimistic about the upward trend of foreign direct investment flows on medium term against those on short term. Due to the strong impact of the economic and financial crisis, transnational companies remained cautious about the transfer of assets abroad, but also about the expansion in other regions.

Almost half of respondents (45%) indicated a major reduction in their own international investment programs. 10% of the respondents withdrew their investments from their subsidiaries abroad, while 18% have closed or sold the subsidiaries abroad. Based on these responses UNCTAD estimates an increase of foreign direct investment flows between 1900-2000 billion USD, in 2013.

Not only transnational companies are optimistic about the increase of foreign direct investment flows and implicitly the growth of world economy. Governments in euro area consider that a small number of states will be affected by a possible sovereign debt crisis. If in 2012 world gross product grew by 2.6%, an increase of 3.3% is expected in 2013.

There is also a pessimistic scenario caused by the failure in implementing financial recovery policies in the European Union and the United States of America, the issues raised by the increase of the number of unemployed people, the prevention of sovereign debt crisis and fragility of financial sector, which lead world economy to a new recession.

The vulnerability of the international financial system affects the financing available for development. The uneven pace for recovering the economies at global level, the risk of sovereign debt crisis in Europe and the effect of liquidity increase in European interbank market increased the aversion to risk and led to an increased volatility of private capital flows.

Waves of capital inflows that are in excess of the absorptive capacity of an economy have a negative effect manifested by: the increase of exchange rate, the increase of inflation and an unjustified increase of assets price.

Also, volatile capital flows, present risks to the economic and financial stability, with the threat of a sudden stop of these flows manifested simultaneously with the withdrawal of invested capital, which would lead to the spread of the financial crises.

For this reason, many countries have decided to establish international reserve funds to Project themselves against the abovementioned phenomena. In 2011, developing countries have added 1100 billion USD to the reserve fund, totaling 7000 billion USD.

Also, the international community has taken steps to reduce global risks and to strengthen the international financial system by introducing new financial regulations (Basel III Agreement).

In the United States of America a series of similar measures known as Dodd-Frank Law were adopted. This has a reform role in the American financial system, and also a role of protecting the consumers against banking services.

The need for financial security and the elimination of the risk of debt crisis occurrence, led to the creation of temporary financing facilities in Europe through the European Stability Mechanism (ESM) with the component elements European Fund of Financial Stability

[4] Own translation from World Economic Situation and Prospects, UNCTAD, New York and Geneva, 2012

(FEFS) and European Mechanism of Financial Stabilization (MESF).

However, the spread of crisis effects in Greece to larger economies in the European Union in the second half of 2011 suggests that these measures were not sufficient. The capacity of this system appears to be limited, not coping with the problems related to the sovereign debt of some countries like Italy and Spain.

Mechanisms similar to those in Europe should also exist in other developed countries because many of these, especially the United States of America, will face a new mortgage crisis.

These countries should make sure that macro-economic policies are a transparent part of a cyclic framework, which includes funds for financial stability and implementation of financial regulations also on the capital account for mitigating the impact of the price for raw materials and volatile capital flows.

In World Economic Situation and Prospects (WESP) 2012 four priorities that the United States of America and the states in euro area should fulfill for the financial stability, are proposed[5]:

- stimulation of demand, in order to reduce unemployment, particularly through public investments and creation of new jobs. Also, investments in infrastructure and other structural modifications for the stimulation of medium-term exports;
- redesign of fiscal and economic policies in order to strengthen the impact on the labor force and to help its transition from a system base don demand to a system that promotes structural changes for a durable development;
- finding of a new synergy between the financial and monetary system as a counter measure against the effect exercised by the increase of exchange rate and volatile capital flows;
- provision of sufficient resources at the disposal of developing countries, especially at the disposal of those which possess a limited fiscal space and face high needs for development.

Finally, I believe that the simultaneous manifestation of the above situations would lead to a new recession which, through a domino effect, would attract all the developed countries followed by the developing countries, due to the connections that are established between them.

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