IMPACT OF FOREIGN INVESTMENTS ON THE BALANCE OF PAYMENTS, TRADE DEFICIT AND EXCHANGE RATE EVOLUTION IN ROMANIA

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Abstract

Foreign investment inflows can both positively and negatively affect a country's balance of payments. The balance of payments reflects economic and financial transactions, which relate to goods, services, income, transfers and receivables, and financial obligations with external partners. Vertical foreign investments speculated on the production of part of the final product will impose exports, and horizontal ones, in which the business model of the home market is imitated, will increase imports.

Keywords: balance of payments, trade deficit, exchange rate, fdi, impact of fdi

1. Introduction

The concept of investment designates a placement or, under certain circumstances, the monetary value of this placement (Pralea, 2001). The investment is defined as the total income saved and allocated for the growth and modernization of the assets of an economic agent and materialized in fixed tangible assets - land, buildings, machinery, equipment, intangible assets, managerial skills, and financial assets in order to obtain net income for a long period of time (Vasilescu and Românu, 2003).

Foreign direct investments are seen (Griffin and Pustay, 2007) as the ownership or control of at least 10 percent of the voting rights or subscribed capital of a resident enterprise. Foreign investment is defined as a package of capital, technology, management that allows a foreign firm to operate and deliver goods and services on a foreign market (Farrel, 2008).

Dunning (2001) considers that property, location, and internalization benefits must be met in order for foreign direct investments to materialize,

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noting that "the OLI Triad of Variables determines foreign direct investments of multinational companies and can be likened to a three-legged chair . Each leg has the function of supporting the others, and the seat is only functional if the three legs are equally balanced. "Even if a company can obtain the advantages of ownership and internalization, without the advantages of location, the company will increase production in the country of origin and exports to that area. If there are advantages in terms of ownership and location, the company will prefer to produce abroad and export to the country of orignine.

Moraru (2008) discusses the issue of foreign direct investments in Romania and the impact on economic growth in the period 2003 - 2011. The analysis uses an econometric model in which foreign direct investments is the independent variable and the dependent variable is GDP. The conclusions of the analysis point out that the fluctuation of foreign direct investment flow has little impact on the economic growth during the analyzed period.

2. The evolution of balance of payments, trade balance and exchange rates of the Dollar and the EURO against Romanian Leu

Table 1 presents the data on the balance of payments balance of Romania in 2000 - 2015.

Table 1. Evolution of the Balance of Payments Balance of Romania in the period 2000 – 2015

Year	Current Account (millions EUR)	Capital Account (millions EUR)
2000	-1.363	1.230
2001	-2.317	1.499
2002	-1.623	2.493
2003	-2.877	3.171
2004	-5.099	4.215
2005	-6.888	6.483
2006	-10.156	9.532
2007	-16.677	17.269
2008	-16.157	17.830
2009	-4.913	5.883

2010	-5.493	5.728
2011	-5.938	5.498
2012	-6.052	1.881
2013	-1.168	3.038
2014	-1.012	3.954
2015	-1.943	3.901

Source: Processing by National Bank of Romania Reports, Balance of Payments and International Investment Position of Romania, 2000 – 2015

Between 2000 and 2006, the negative balance of the current account was due to the increase in imports, the increase in domestic consumption, insured from external resources and the income obtained by non-resident companies from foreign direct investment. The capital account had a positive evolution due to the improvement in Romania's rating, which facilitated access to capital markets and foreign investment in banking and finance.

Between 2007 and 2008, the level of imports of goods has seen new growth, and the drop in exports, especially oil and textile products, has led to an even deeper deficit in the current account. The capital account balance increased by 81.2% in 2007 compared to 2006 due to the large volume of contracted loans and the large profit reinvested by local firms.

The economic turmoil caused by the financial crisis has reduced exports and low domestic demand has further affected imports, with the deficit falling by 69.6% in 2009 compared with 2008. Domestic demand has continually decreased between 2009 and 2015 and imports were more limited, but the revival of external demand has boosted exports that have increased during this period. The short-term credit preference given by the aversion of the crisis, the lower levels of foreign direct investment, and the decrease in the level of absorption of European funds have made the capital account to decline between 2009 and 2015.

Table 2. Trade Balance of Romania, 2000 – 2015

Year	Exports (millions EUR)	Imports (millions EUR)	Trade deficit (millions EUR)
2000	11.273	14.235	-2.962
2001	12.722	17.383	-4.661
2002	14.675	18.881	-4.206
2003	15.614	21.201	-5.587

2004	18.935	26.281	-7.346
2005	22.255	32.568	-10.313
2006	25.850	40.746	-14.896
2007	29.549	51.322	-21.773
2008	33.725	57.240	-23.515
2009	29.084	38.953	-9.869
2010	37.360	46.869	-9.509
2011	45.292	54.952	-9.660
2012	45.069	54.703	-9.634
2013	49.562	55.317	-5.755
2014	52.466	58.522	-6.056
2015	54.596	62.962	-8.366

Source: National Institute of Statistics (www.insse.ro)

Table 2 shows the Romanian Trade Balance, broken down by exports, imports and trade deficit. Increases in household incomes and easy access to credit, have boosted consumption, and the limitation of products and services on the local market has boosted imports. A major deficit was recorded between 2005 and 2008, the peak being reached in 2008, when the difference between exports and imports reached 23.515 million.

Since 2009, when the impact of the crisis has been felt by the national economy, imports have shrunk by 46% compared to 2008 and exports by 28% in the same period.

The imprint of the economic crisis has remained in the downward period, and the drop in lending volume and low demand have led imports to remain at a steady level between 2010 and 2014. Economic and population growth in 2015 has boosted imports this year, which reached the maximum of the analyzed period of 62.962 million euros. In the case of exports, the growth was even higher in the post-crisis period, rising by 84% in 2015 compared to 2009, due to the large world demand for the main goods exported by Romania (cars, car parts and accessories).

Table 3. Evolution of the exchange rate of the dollar and the European currency against Romanian Leu in the period 2000-2015

Year	USD/RON	EUR/RON
2000	2,171	1,878
2001	2,906	2,456

2002	3,306	3,143
2003	3,320	3,695
2004	3,264	4,081
2005	2,914	3,616
2006	2,809	3,531
2007	2,438	3,284
2008	2,519	3,637
2009	3,049	4,210
2010	3,178	4,274
2011	3,049	4,261
2012	3,468	4,513
2013	3,328	4,404
2014	3,349	4,421
2015	4,006	4,424

Source: Processing based on data provided by the World Bank and those provided by the National Bank of Romania

Table 3 presents the developments in the exchange rate of the dollar and the euro against the local currency, the leu for the period 2000-2015. Compared to both currencies, the leu experienced depreciation, especially in the post-financial crisis. The increase in international trade in the countries that make up the „hard core" of Europe and the growth of the US economy since 2010 have made both the leu and the other currencies in the region depreciate compared to the euro and the dollar. Another reason for the depreciation of the leu is the fiscal and political instability, which characterized the local economy in the last period of the analysis.

3. The analysis of the impact of foreign investments on the balance of payments, trade deficit and exchange rate evolution in Romania

As a method of researching the implications of foreign investments on the balance of payments, the trade deficit and the evolution of the exchange rate in Romania, a quantitative approach is needed and the method used will be the regression analysis. The program used is SPSS v20 and the dependent variables are: current account balance, capital account balance, value of exports and imports, trade deficit, RON / EURO and RON / RON between 2000 and 2015. The independent variable is considered the value of the foreign direct investment stock, in order to analyze the implications on the dependent variables.

The data for Pearson coefficient value, the test value F, the t test, and the regression significance coefficient are centered in Table 4.

Table 4. Correlation test results, ANOVA and regression coefficients for the impact of foreign investment on the balance of payments, trade deficit and exchange rate evolution in Romania

	Pearson	F - test	t - test	Sig.
Sold cont curent	-,243	0,879	-,938	,364
Sold cont capital	,126	1,429	1,195	,252
Exports	,909	66,323	8,144	< 0,001
Imports	,942	110,875	5,029	< 0,001
Comercial Deficit	-,401	2,683	-1,638	,124
Dollar exchange rate	,284	1,232	1,11	,286
EURO exchange rate	,761	19,221	4,384	,001

Correlation analysis shows that the stock of foreign direct investment has no impact on the current account and capital account balance, the trade deficit indicator and the dollar exchange rate. A more in-depth analysis of the components of the current account, goods and services and capital, direct and portfolio investment could explain to what extent foreign investment influences the balance of payments.

Although at the indicator level, the trade deficit is not influenced by the foreign direct investment stock, both exports and imports get a correlation close to the absolute value of 1, with a significance threshold less than 0.001 in the regression test. The value of imports and exports shows that they increase with the increase in the balance of foreign direct investment. Consumption-based economic growth, which is mainly driven by imports, pushes foreign companies to enter the Romanian market in order to increase their profits. By opening subsidiaries in Romania, local dealers and traders are bypassed, making profits higher and easy to repatriate once the investment on the local market has matured. And in the case of exports, they are strongly influenced by the foreign direct investment stock. Cheap and skilled workforce helps to reduce costs and maximize profits for companies seeking exports of a finished goods or services. Multi-national companies can use transfer pricing to avoid taxing in Romania, and so reduces the total value of exports nationwide.

The level of the dollar's quote against the leu is not influenced by foreign investment, but the European currency, EURO, has a statistically significant correlation with a significance threshold of 0.001. The value obtained in the case of the Euro can be explained by the presence of foreign investors, mainly from the European Union. The United States, Japan and China account for only 3.2% of total foreign investment in the year 2015. The presence of foreign, predominantly European foreign companies has a negative impact on the exchange rate, leading to the devaluation of the leu against the European currency. The lack of Romanian investments outside its borders, the 38% of foreign investments in the Gross Domestic Product and the high export share of foreign companies of 73%, as well as the financial system dominated by foreign banks, lead to a decrease in the Leu's demand and its devaluation. Payments related to exported goods are made between foreign affiliates of multinational companies and the export market. As most exports are destined for the European Union, especially Western countries, the currency used by multinational companies for these exports is the Euro. Local currency is not used in these practices, and this leads to a decrease in demand and, at the same time, to its devaluation.

4. References

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