

## **FOREIGN DIRECT INVESTMENTS: THEIR EVOLUTION AND IMPORTANCE IN ROMANIA**

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### **Abstract**

*Investments are seen as the engine in any economic activity, regardless of its size. Starting from the objective started by the economic entity, it also contributes through the investments made to the harmonious development of the national economy, materialized in the growth of jobs, connection to international production networks, diversification and modernization of production capacities, increase of business environment sophistication etc. Globally, the economy has been increasingly unpredictable in recent decades, a period characterized by sudden changes, by the impact that the evolution of technology has had in certain sectors, rapid technological progress and by major economic disparities between highly developed, developing and underdeveloped states. Technological progress has a strong impact on the development of a country's economy. Foreign direct investment brings the "know-how" needed for technological progress. The companies, together with the society's members, are the connecting factors through which this process of economic development propagates. This paper aims to assess the net impact of the presence of foreign companies in Romania in recent years.*

**Keywords:** *Foreign Direct Investments, Economic Growth, Greenfield*

**JEL classification:** *F21*

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### **1. Introduction**

Foreign direct investment and their efficient exploitation is an effective solution for the internal and external supply of goods and services, respectively for a real economic growth. Foreign direct investment is

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manifested worldwide through firms and currently has a considerable global influence on national economies, bringing both positive and negative effects within them. Developing countries are much more vulnerable to foreign investment because, on the one hand, they need their know-how and experience in certain sectors, and on the other hand, they are not developed enough to cope with the opportunistic behavior they show in their pursuit of profit. To avoid these risks that come with FDI, the state must have well-founded policies. The number of companies with foreign capital, their dynamics, their ability to create value, profit distribution, profit reinvestment, the number of jobs created, all affect economic growth and sustainable development.

Romania being a developing country, is strongly affected by the flow and migration of foreign direct investors this aspect being visible after the fall of communism when companies with foreign capital were allowed to enter the Romanian economy. The period 1990-2018 is characterized by the progress that the Romanian economy has made, from socialism to free market and then to the European Union and by the sustained efforts not only of accession but also of integration. Since the 1990s, Romania has been perceived by investors as a risky market, but now Romania's economy tends to become more stable, making it possible to move to a sustainable economy.

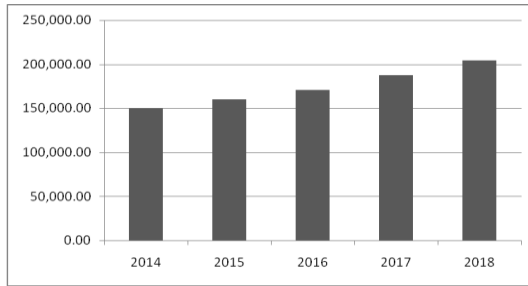
It is desirable for the level of foreign investment to increase, first of all, because FDI is a catalyst for both a short and a longer period. Through the transfer of know-how, through the contribution of physical and financial capital, respectively by increasing the productivity of production factors, in the medium term, investments directly contribute to the creation of favorable perspectives for research, development and innovation. In terms of long-term effects, it not only contributes to the creation of new jobs, but also contributes to the diversification of types of jobs, which leads to the specialization of the workforce and the raising of education level.

International studies have shown that FDI leads to technology transfers, supports the training of human resources, contributes to better integration into the international trade system, helps to create a more competitive business environment and supports the development of enterprises (Camelia Moraru, 2013). In turn, these effects contribute to an acceleration of economic growth.

## **2. The evolution of foreign direct investment flows at national level in the period 2014-2018**

For Romania, the years 2014-2018 represented a period of economic boom in which it was invested significantly, in all branches that are subject to the national economy. The most appropriate indicator for measuring economic growth is the gross domestic product. The following graphic illustrates the upward evolution of this indicator during the analyzed period.

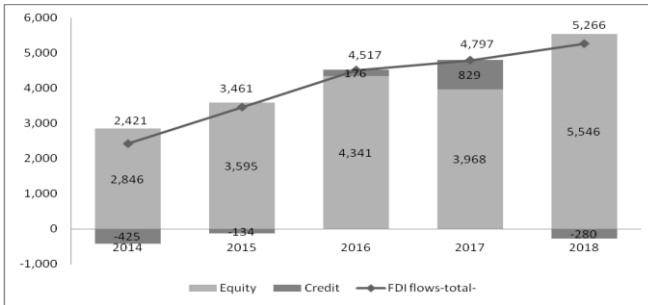
**Figure 1: Gross domestic product at market prices in Romania- EUR milion-**



Source: own processing based on data provided by the NBR

Economic growth depends to a large extent of foreign investment flows, improving the total productivity of the factors of production factors and, more generally, the beneficial efficiency (Foreign Direct Investment for Development, 2002). In the analyzed period 2014-2018, in Romania, foreign direct investments registered a positive trend, due to the flow of FDI from the EU to our country. Foreign investors have observed relatively large profit opportunities in the Romanian economy, both in the form of greenfield investments and through mergers and acquisitions. According to the statistics of the “National Bank of Romania”, figure no. 2 shows the evolution of the foreign direct investments flow in the period 2014-2018. The net FDI flow is an indicator that reflects the amount of investments made by foreign companies in our country, which is composed of equity participations (the amount between capital contribution and reinvested profit) and net loans from foreign direct investors. It is noted that, in 2018, the net flow of FDI came to be twice as high as that recorded in 2014. Public expenditures made continuously by the Romanian state created a favorable investment environment that attracted foreign investors, eager to bring capital contribution to our country.

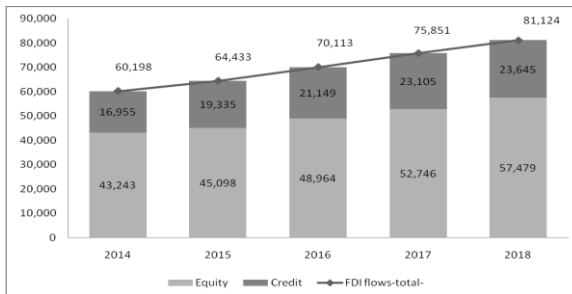
**Figure 2: Foreign Direct Investment (FDI) flows in 2014-2018- EUR million-**



Source: own processing based on data provided by the NBR

At the end of each year, by adding to the net FDI flow obtained at the end of the previous year, are added the components leading to the various variations, such as favorable / unfavorable differences arising from the revaluation of assets denominated in foreign currency due to changes in exchange rates, revaluation of the prices of tangible assets, changes in the market value of FDI companies listed on the stock exchange, resulting the FDI stock. According to figure no. 3 on 31.12.2018 the FDI balance was 81.124 million euro. The equity (including the accumulated reinvested profit) of FDI enterprises owned by non-residents at the end of 2018 amounted to 57.479 million euro (70.85% of the FDI stock), and the net credit received by them from foreign direct investors ( including within the group) had the value of 23.645 million euro (29.15% of the FDI stock).

**Figure 3: Foreign Direct Investment (FDI) stock in 2014-2018- EUR million-**



Source: own processing based on data provided by the NBR

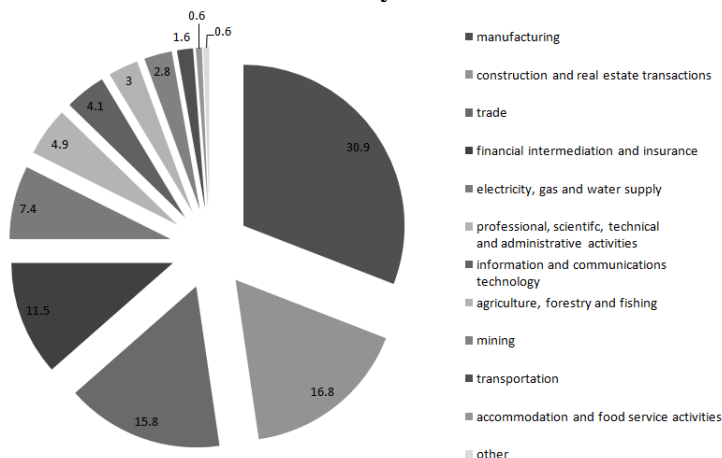
The segmentation of FDI by branches helps to carry out a detailed analysis of the relationship between foreign investment and sustainable development. In addition, the analysis of FDI by branches highlights the contribution brought by foreign investments in the sectoral increase of the salary level.

According to the statistics of the “National Bank of Romania”, the balance of foreign direct investments as of 31.12.2018, is distributed on the main economic activities as follows:

- Most FDI was attracted in the industrial sector (41.1%), especially the manufacturing industry (30.9%). Within this industry the most important branches are the means of transport industry (6.7%), crude oil processing, chemicals products, rubber and plastics (6.4%) and metallurgy (3.9%);
- 16.8% was registered in the construction and real estate transactions sector;
- The trade sector, dominated by hypermarkets on the retail side, registered 15.8%;
- 11.5% financial intermediation and insurance;
- The electricity, gas and water sector attracted 7.4%.

Investors focus on these areas of activity due to the fact that they have the opportunity to quickly recover their investment. They are also interested in investing in strategic areas, such as renewable energy, with government support, through the national sustainable development strategy 2030. In 2018, the manufacturing industry is the largest employer in the economy, and in terms of turnover it is on the first place, followed by construction and the real estate market. In recent years, the real estate market has shown a positive trend, 2017 registering an obvious evolution. All predictions related to the evolution of the real estate market are closely linked to economic factors. The most important influence in recent years has been sustainable economic growth and the willingness of banks to provide financing. In the near future, although it seems to be constantly evolving, the real estate sector may experience declines, due to poor infrastructure, a visible problem without concrete solutions to be solved throughout the country.

**Figure 4: Distribution of FDI stock as at 31 December 2018 by main economic activity**



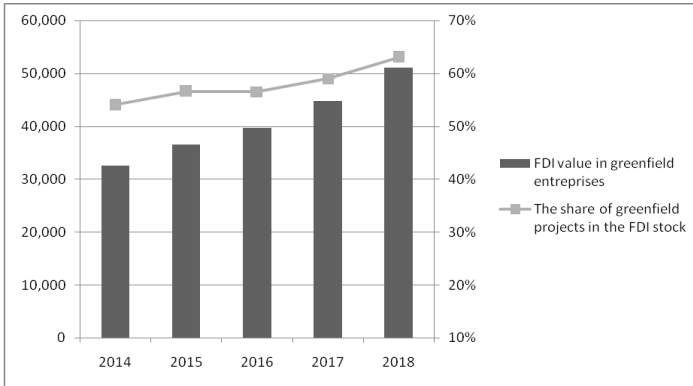
Source: own processing based on data provided by the NBR

Among the operations included in FDI, meaning greenfield projects, mergers and acquisitions, company development and company restructuring, greenfield projects denote the highest level of trust from a foreign investor, as they represent a medium and long-term investment.

New FDI investments - greenfield registered a constant increase in the analyzed period, as a nominal value. As a share of the total value of FDI, greenfield investments were permanently above 54%. In 2018, almost 63% of the total FDI (51.150 million euro) were new investments, made from scratch. Such an evolution signals that our country present interest to foreign investors and that the development potential in this direction is high and needs to be exploited.

Most new investments, in value, were made in 2018, in the manufacturing industry (28.9% of total FDI), construction and real estate transactions (19%), trade (17.6%), financial intermediation and insurance (9.3%). As effects of these investments are the following: existing FDI enterprises will attract around them the suppliers or intermediaries they need in the production process (for companies in the industry) in the form of new foreign investments, while trading companies and financial intermediaries will find sales market. Therefore, productivity will increase and new jobs will be created.

**Figure 5: Evolution of greenfield investments, 2014-2018**



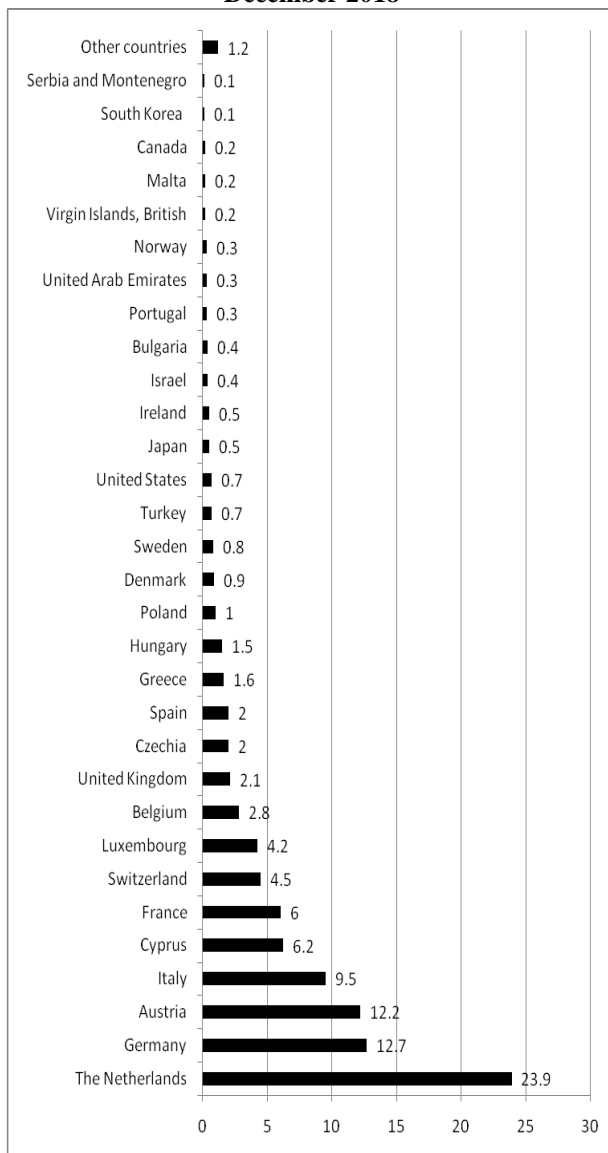
Source: own processing based on data provided by the NBR

### **3. The main companies that invest in Romania**

Multinational companies that have had foreign investments in Romania over the years, have changed the way of life and mentality of Romanians after the revolution and until now. The big investors came to us with international know-how, brought new production technologies and taught us what productivity and high-performance management systems mean. The companies that have invested long-term in Romania have contributed in an essential way to the modernization of the Romanian economy and to the improvement of the living standard of the Romanians.

Regarding the main investors, it is observed that mainly the investors from our country come from the Member States of the European Union, and FDI is distributed in all sectors of the economy. The chart below shows the ranking of states investing in Romania. The top five countries, after the share held in the FDI stock at the end of 2018, are: The Netherlands (23.9%), Germany (12.7%), Austria (12.2%), Italy (9.5%) and Cyprus (6.2%). Compared to the previous year, Italy consolidated its fourth position, while Cyprus surpassed the position of previous years, reaching the fifth place. In other words, the Netherlands, Austria and Germany together have 40% of the total investments, the European Union being the main trading partner of Romania, with over 90% of the foreign investments in our country coming from the EU.

**Figure 6: Foreign direct investment in Romania by country of origin as at 31 December 2018**



Source: own processing based on data provided by the NBR



According to the value of Romania's exports, the top countries that invested in Romania in 2018 were France, Germany and Italy. Transport services, goods processing services, respectively IT&C services generate the largest exports in Romania, being among the economic sectors that contribute to balancing Romania's trade balance, along with exports of goods from the automotive industry. Also, manufactured products generate significant exports. They represent over 75% of total Romanian exports. The economy produces more finished products, with high added value, which attracts a horizontal economic development, in which more and more companies are involved. (\*)

#### **4. Conclusions**

One of the most common and debated issues related to FDI is the effects they have on a country's economic and social well-being. Although there are controversial discussions, I believe that FDI should be seen more as a generator of competitiveness and growth and less in terms of their negative effects on the economy.

Romania has captured the interest of foreign investors, who have made new investments here, from scratch (greenfield) - offering jobs, supporting consumption and developing production capacity. In addition, the long-term interest in supporting the Romanian economy is proven by the concentration of investments in industry, most of the FDI stocks (41%) being made in this sector in 2018.

In order to attract and maintain FDI, while maintaining and amplifying the positive effects, I believe that two directions of action should be followed:

- Increasing the absorption capacity of the economy. Because the positive impact of FDI in the economy of the host country depends on its absorption capacity, Romania must focus its efforts on increasing the quality of human capital, on technological development and innovation, but also on ensuring an attractive legislative framework.
- Development and implementation of a strategy to attract FDI. Although an increase in FDI has been reported in recent years, the continuation of this trend and the positive results on the entire Romanian economy are limited by the lack of a strategic document to concretely stimulate FDI. Also, the development of very well-founded policies will create an attractive environment for foreign investors,

will make Romania a strong negotiating partner, which will automatically contribute to the economic development of the country.

## **5. References**

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