

STRUCTURE, ROLE AND IMPACT OF THE FDI ON ECONOMIC GROWTH IN ROMANIA

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Abstract

Foreign direct investment (FDI) represents one of the ways to finance any economy. In this study I approached the theme trying to reveal the structure and role of the foreign direct investment in Romania and also the impact on economic growth. Using interpretations, correlations and analytical methods I drew conclusions on the categories of foreign direct investment, net foreign investment flow, economic growth. I also analyzed the relationship between FDI and GDP as one of the main macroeconomic indicators of the result, highlighting the percentage and trends of FDI in GDP in Romania between 1990 and 2019. I concluded and revealed the directions where foreign direct investment is needed in Romania in order to have an economic growth and also to support a sustainable development of our country.

Key words: *foreign direct investments, economic growth, sustainable development, gross domestic product*

JEL classification codes : *F21, F43, O4, E27*

1. INTRODUCTION

Foreign direct investment has an important role to play in stabilizing macroeconomic processes in Romania and in economic growth, although the drive and propagation effects have not been fully exploited, with some key issues still to be addressed.

In the article I first propose to clarify and to express the concept of direct foreign investment in order to determine the implications of foreign direct investments on Romania's economic development. In the second chapter I will highlight the structure, role and evolution of foreign direct investment in Romania and their contribution to the sustainable development of our country as well as the directions in which foreign direct investments are needed in Romania to support the sustainable development of our country. I will use analytical methods, interpretations and correlations, to draw conclusions on the evolution and trends as well as the consequences of foreign direct investments on the sustainable development of Romania.

For international investors, foreign direct investment has an extremely important role, the emerging markets that are growing, are certainly due in large part to FDI. At the same time, companies that invest abroad can achieve higher growth rates and diversify their revenues. This represents the creation of new opportunities for investors. A great importance is given today to the topic of interest of foreign direct investment (FDI), we can say about them that they can be a factor to stimulate growth and economic.

Economic growth is an advantage, we could say key, of foreign direct investment. Those countries in which new foreign investments are developed and not only, have to do with a considerably higher economic growth, supported by the commercial opening to new markets. This can be easily seen in many emerging economies.

When we talk about the global FDI situation nowadays, it is clear that the trend is not a positive one.

While foreign flows for example: from the United States in the second half of 2018 recovered from the negative values of the first half, US foreign investment is likely to be lower due to reduced reinvestment of earnings to foreign partners. For the second year in a row, China also saw a decline in FDI flows.

In the current situation, many governments have taken strict public health measures to limit the spread of the COVID-19 pandemic. These public health measures have caused severe economic

disruption that has impacted companies' decisions on foreign direct investment (FDI). Governments have also taken significant economic policy actions to reduce or cushion the economic consequences of the public health crisis. The eventual impact on FDI flows will depend on the success of these public health and economic policy restrictions. FDI can be quite important to support economies in the period of economic recovery after the pandemic. Evidence from past crises has shown that foreign-owned affiliates, including SMEs, can demonstrate greater resilience during crises due to their ties and access to the financial resources of their parent companies.

2. THE ORIGIN, STRUCTURE AND DEVELOPMENT OF FOREIGN DIRECT INVESTMENT IN ROMANIA

Investment in the national economic literature is conceptually structured by two major meanings or in other words, the term of investment has two spheres of significance, one more represented by financial investments and the other more restricted by capital investments. Financial investments involve transactions and consist of any capital investment made in order to obtain dividends, interest and profits, respectively, from the purchase of funds for the initiation of business that is, the totality of expenditures and allocations of funds from which future revenues are expected, with a different typology: the technical investment, regarding the acquisition, construction and assembly of fixed assets; human and life investment of employees; financial investment, consisting of the purchase of equity securities in other companies; commercial investment, for advertising.

In the economic literature, it is difficult to draw a clear line of distinction between the entrepreneurial climate and the climate or the investment environment as investment is the essence of any business and the ultimate goal of an investment as any business itself is to obtain profit, as well as recovering the investments made as quickly as possible. Investment is the main way to develop or at least maintain the productive force of an enterprise, implicitly an economy, viewed as an aggregate of all economic subjects.

If an enterprise has a growth rate lower than its average market benchmark or specific activity, it results in the company's bankruptcy in the medium and long term as a result of progressive customer loss, market share, competitiveness, and analogy if an economy lowers the pace of investments, implicitly reduces economic growth, or can even result in a decline in real GDP.

For Romania, as a member state of the European Union, sustainable development is not an option but an obligation of national becoming, in order to implement a new paradigm of development through the confluence of the economic, social and environmental factors.

As a result, in 1997, the National Center for Sustainable Development, under the aegis of the Romanian Academy, was established, whose aim is to identify Romania's sustainable development priorities and to propose concrete projects at national and local level in order to achieve these priorities.

In 2008, the National Strategy for Sustainable Development was approved for the period 2013-2020-2030, aiming at the significant rapprochement of Romania with the average level of the European Union countries to the main indicators of sustainable development foreseen in the Union's Revised Sustainable Development Strategy of the European Union since 2006, through a medium and long-term accelerated development in all three key components (economic, social and environmental). Among other sources of funding to implement the objectives of this strategy, foreign direct investment is foreseen.

In addition, Romania's sustainable development strategy includes specific problems and concerns of Romania (agricultural property structure, access to drinking water and sanitation, transport infrastructure, energy efficiency and consumption of resources relative to GDP, labor productivity, state general health, quality of vocational training etc.).

In 2013, the Department for Infrastructure and Foreign Investment Projects was set up with an important role in promoting the Romanian investment environment in international business

environments. The department identifies the investment opportunity in both the private and public sectors that it presents to foreign investors. The Department for Infrastructure and Foreign Investment projects also has other tasks as:

- examines the proposals of foreign investors;
- provides assistance and consultancy to foreign partners;
- evaluate investors' reactions;
- concludes conventions and agreements with institutions and specialist firms from other countries.

In this context, I believe that in our country, foreign direct investment is needed to support sustainable development in several specific directions that will be presented below.

In the Romanian economy, it is vital to attract foreign direct investment in areas that deliver high value added (automotive, electronics, pharmaceutical), cost-effective and high-tech (telecommunications and IT etc.), focusing on the use of renewable or recyclable resources to support economic growth (by increasing the technological level of production, specialization in high-tech areas, improving the quality of goods and services produced in the economy), but also the efficiency energy and resources.

I believe it is necessary for Romania to be part of energy routes, to have access to resources.

In industry, it is important to focus on renewing the technology base, respectively endowment with medium and high complexity technologies with important driving effects and which can make a substantial contribution to increasing the volume and efficiency of exports, adaptability to market requirements.

Thus, through the in-flows of foreign direct investment, labor productivity can be increased on the whole economy (GDP per person employed), but also at sectorial enterprise level (gross value added per employee), as well as improving the resource efficiency, which are the main determinants of efficiency and competitiveness and implicitly, the sustainability of economic and social development, as well as environmental protection.

In addition, it is desirable to attract foreign direct investments in areas where Romania has comparative advantages in order to capitalize and in areas of national interest.

Such an area is represented by agriculture whose development, especially of organic products, is desirable to capitalize on the comparative advantages of our country (high quality agricultural land and productivity). Foreign direct investment can also support the modernization of agriculture and increased yields in this sector.

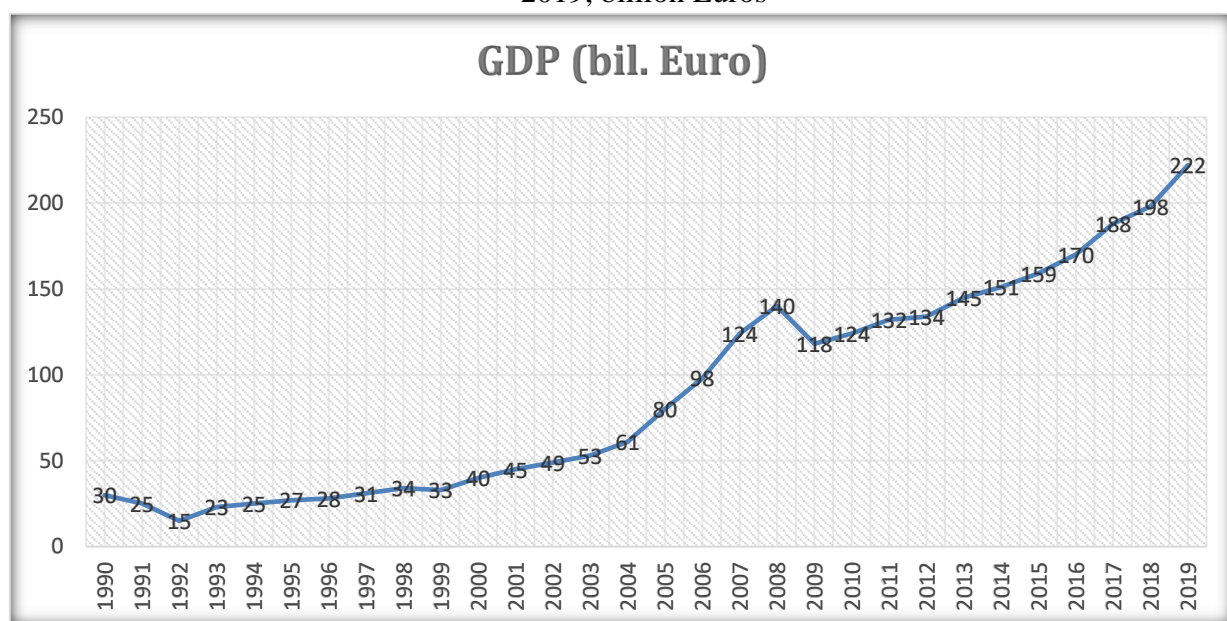
3. DYNAMICS OF FDI AND GDP IN ROMANIA BETWEEN 1990-2019

The economic growth analysis of a country is complex; determinant is the combination of many variables involved in their contribution to the Gross Domestic Product (GDP) and growth rate. The study of the main variable is essential, especially for decision-makers, to promote a further increase of that variable.

National investment is the most volatile component of macroeconomic outcomes, GDP is frequently followed by direct portfolio investment, while foreign direct investment is the more stable component and practically accounts for many more determinant variables being designed on a timely basis.

In this chapter I will analyze FDI in terms of the evolution of flows, I will present a comparative analysis of FDI with the countries of Central and Eastern Europe, a region of which Romania is part. I will also refer to their evolution over time in order to have a broader perspective and to recognize some specific characteristics. I will conclude by presenting the evolution of FDI between 2017 and 2019 and I will outline the premises for the next period.

Figure 3.1 The evolution of GDP in Romania, in the period 1990 - 2019, billion Euros



Source: own processing <https://www.theglobaleconomy.com/Romania/> [accessed 15.08.2020]

In order to properly assess the issue of FDI development in Romania, I will make an analysis, based on data taken from the National Bank of Romania. For this purpose, I processed Figures 3.1, 3.2 and 3.3, which highlight the evolution of GDP and FDI in Romania, as well as the annual changes in FDI.

Figure 3.2 The evolution of the FDI flow in Romania, between 1990 and 2019, billion Euros

Source: own processing www.bnr.ro [accessed 01.09.2020]

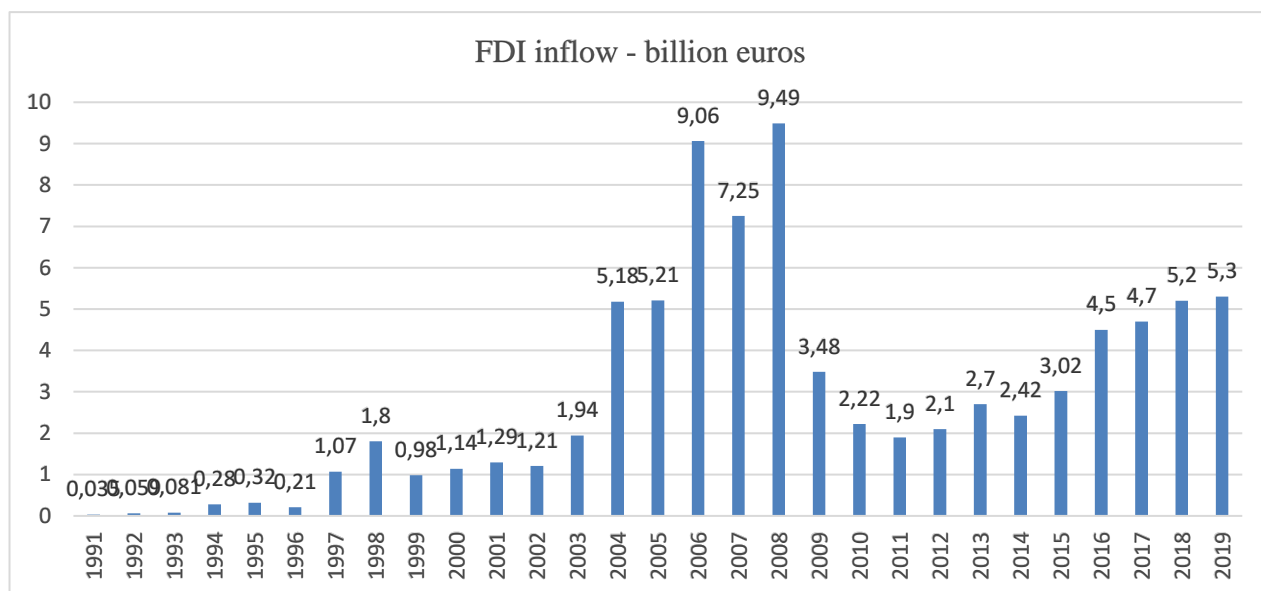
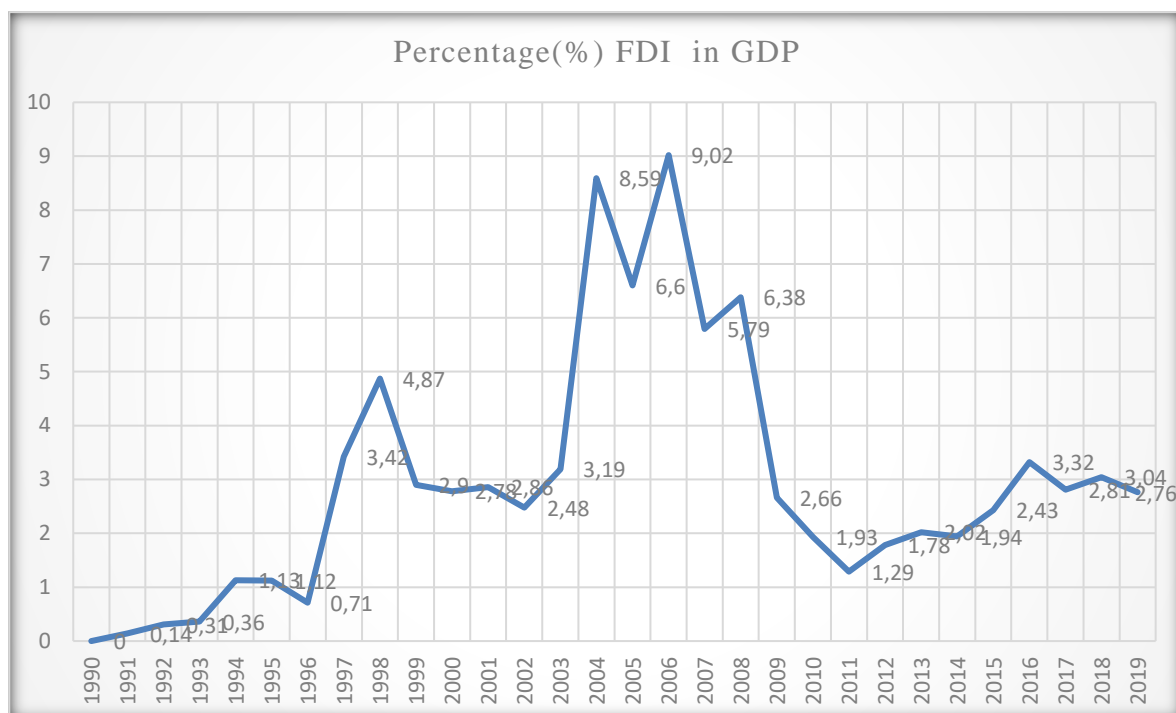


Figure 3.3 FDI in GDP in Romania, during the years 1990 - 2019, billion Euro Source: own

processing www.bnr.ro accessed 28.08.2020

Between 1990-2019, the volume of FDI increased significantly in Romania. We can explain this fact considering that the level of FDI was almost non-existent at the beginning of the transition period and, on the other hand, due to the gain opportunities that foreign investors were able to capitalize on in Romania, either through greenfield FDI or F&A or portfolio investments in the capital market.

When we look at Romania as a possible area for the development of new enterprises, foreign investors certainly carefully analyze the advantages of our country, advantages that can be grouped as follows: (Romania's National Export Strategy 2014-2020, SNE, MINISTRY of ECONOMY, Department of Foreign Trade and International Relations).

Looking at the market advantage and location we are one of the largest markets in Europe - we are in 7th place with a market of over 20 million inhabitants. We can establish ourselves as a gateway to a single EU market.

The location is attractive and we have the major advantage of resources, a fairly well-qualified workforce at a cost that is still quite competitive, we are rich in natural resources and we have a very high tourist potential.

From the point of view of political advantage, we are a member state within the EU, from the point of view of the strategic partnership with NATO we are a factor of stability for the entire South-East area of the EU.

If we look at international relations, we can also outline legislative advantages, by the fact that we have managed to transpose EU legal provisions into our legislation. And last but not least, we can mention some advantages, such as: well-developed telecommunications networks, a well-developed petrochemical infrastructure as well as the advantage of the presence on our market of many branches and subsidiaries of many established banking institutions.

When we talk about the evolution of FDI in Romania in the period 1990-2009, we can distinguish four periods: the first period is between 1991-1997, the second period brings together the years 1998-2003, the third period includes the years 2003-2008, the last is the period after the economic crisis.

The period really relevant for an examination of FDI begins only in 1990, given that during the communist period there were no de facto stocks or flows of FDI in Romania. Thus, in 1989 there were five foreign investors as Joint Ventures with Romanian companies.

So it started from an extremely low base. After enormous debates, only in the mid-1990s - with annual growth rates of up to 400 percent, which took place from a very low level - the growth of FDI increase until the crisis period 2008-2009.

Between 1992 and 2006, investments increased eight times by 30 percent more than in the previous year. For the period 1995-2006, this means an average net increase of over 800 million euro per year. In the record years 2006 and 2008, over 9 billion euros were activated in Romania through FDI.

The sharp decline in FDI after 2008 is explained by the global economic and financial crisis. Romania has also suffered a lot because of this. As a consequence, the Romanian state increased the standard VAT rate by 5 percentage points (from 19% to 24%), and creditors became reluctant. The industrial field was the most affected, given that it was strongly export-oriented and benefited from large international investments, such as: the car construction sector, the construction sector, the steel sector, etc.

As an indicator for overcoming the economic crisis serves the resumed and constant growth of FDI since 2012. In 2015, FDI increased compared to the previous year by 25%, with an absolute deviation of over 3 billion euros. This increase can be confirmed on the basis of current data. The FDI flow until May 2016 exceeds the value of the previous year by approx. 15% (BNR). Gross Domestic Product (GDP) measures the value of goods produced in the country, as well as the creation of added value through the provision of services, as long as they are not used as pre-services for the production of other goods and services.

GDP is currently the most important general economic measure. If we compare the evolution of FDI with that of GDP, we can recognize some common things. In parallel with the increase in FDI, GDP has also increased since the beginning of the new millennium, suffering a fall caused by the financial crisis in 2009. A difference is observed in 2019 when Romania's GDP has increased considerably, we cannot say the same about the share of FDI in GDP, a value that in 2019 was found at 2.76 percent, considerably lower than in 2018, 3.4.

The analysis shows that Romania has evolved over the years in an attractive location for FDI. Numerous government relaxation measures for economic, legal and political investors are responsible for this progress. Despite favorable and non-influential conditions, the main reforms, such as in the field of privatization, stabilization of legal certainty and the fight against corruption, were imposed relatively late due to various internal policy complications, so that the connection with other eastern states -European was made late.

This created, despite good incipient conditions in Romania, considerable competitive disadvantages. In the early years of the reforms, there were problems mainly due to the fact that legislation changed frequently, but also due to poor legal security and an equally weak administrative apparatus, all due in part to corruption.

However, in the field of anti-corruption in particular, there has been remarkable progress in recent years. With a proportional tax rate of 16% of profit and 10% of salary income, the country has an attractive tax system in the European analogy. In general, Romania has consistently implemented macroeconomic reforms and measures for a functioning market and thus improved its competitive position.

At the same time, however, the business and commercial potential are far from exhausted. Future strategies need to be further developed to attract new investors after completion of privatization.

Investments in the entire infrastructure of the industry are strictly and urgently needed, as is the further impetus of reforms. Together with a better disposition and attraction of funds from the European Union, these are the problems that the country has to face for a future success.

The government further indicated the goal of improving the business environment and creating new facilities to attract foreign investors. The country of reforms, Romania, increasingly

considers FDI as a factor of economic development and modernization, as well as increasing the income of the population and the number of jobs. Based on these, Romania has further liberalized the framework conditions of FDI and has taken other steps to attract new foreign direct investment. However, the question of whether there is a link between investment promotion measures and FDI has been clarified. The reforms began to become effective at the turn of the millennium, with the enormous increase in the volume of FDI in Romania.

According to the UNCTAD World Investment Report 2020 as shown in Table 3.1, FDI flows in Romania totaled \$ 6 billion in 2019, a slight decrease from the previous year (\$ 6.2 billion). The total stock of FDI amounted to USD 97 billion at the end of 2019. According to BNR (National Bank of Romania), the main sectors attracting FDI are production, construction and real estate transactions, trade, financial intermediation and insurance. The main investing countries are the Netherlands, Germany, Austria, Italy and Cyprus. Bucharest is the region that attracts the largest foreign capital in the entire country.

Table 3.1 FDI in Romania, inflows, stock, greenfield 2017 - 2019.

Foreign Direct Investments	2017	2018	2019
Inflows FDI (million USD)	5,419	6,219	5,971
FDI stock (million USD)	90,968	92,887	97,095
Number of Greenfield	204	231	260
Value of Greenfield investments (million USD)	5,708	6,251	6,059

Source:
own processing:
[https://unctad.org/](https://unctad.org/en/PublicationsLibrary/wir2020_en.pdf)

[en/PublicationsLibrary/wir2020_en.pdf](https://unctad.org/en/PublicationsLibrary/wir2020_en.pdf)

When we talk about FDI, Romania has many advantages: in addition to a large domestic market, the country has a strong industrial tradition, combined with one of the lowest labor costs in the EU and a well-trained workforce. This was the reason for the development of an important industrial sector, especially car production, but also services. Romania currently still has a low tax rate, certainly one of the lowest in the EU.

The tax regime favors both industrial investment and start-up initiatives. A gradual withdrawal of projects co-financed from EU funds brings investment support, which is expected to recover. However, corruption is still a problem, as is legislative instability and poor judicial independence. Romania ranked 55th out of 190 savings in the 2020 Doing Business report issued by the World Bank (down three positions from the previous year).

3. CONCLUSIONS

The phenomenon studied, namely the impact of FDI on GDP, considered an indicator that best characterizes economic growth, determines a positive relationship between these two macroeconomic indicators. Thus, GDP is sensitive to changes that may occur over a period of time, but economic growth is largely dependent on foreign investment flows. Beyond the initial macroeconomic momentum, FDI has a positive impact on economic growth, improving the overall productivity of the factors of production and, more generally, the efficiency of the use of resources in the beneficiary economy.

In order to capitalize on the potential of foreign direct investment to stimulate and intensify sustainable growth and sustainable economic growth processes, the FDI it is considered to be a factor for increasing efficiency: stimulating the attraction of foreign direct investment of superior technological level; stimulating the formation of an innovative entrepreneurship, capitalizing on the economic opportunities created by the European Union membership - maximizing the absorption of the structural and cohesion funds and their efficient and effective use, contributing in this respect to the development of the physical and institutional infrastructure, ensuring the sustainability of the long-term education and training in order to make the workforce more flexible and more dynamic.

In Romania, in order to increase the medium and long-term investment rate, an suitable and coherent mix of economic policies must be implemented, in which an important role to be played by the policy of attracting foreign direct investment, especially those that can contribute substantially to the development of high added value domains.

Concluding after the analysis made in this research, following the evolution but also the FDI forecasts in 2020 following the partial data provided by the NBR we reach the following conclusions: Foreign direct investment (FDI) in Romania at the beginning of 2020 decreased by 70 % compared to the same period in 2019. This slow start to the year will only be amplified as the health crisis deepens. In these uncertain times, we should look at a SWOT analysis, a strategic way to highlight strengths, weaknesses, opportunities and threats for the future FDI in Romania, so the lack of labor will no longer be a barrier to attracting new investors.

Currently, as a result of the evolution of COVID-19, we are dealing with a forced digitalization not only of the business environment, but of the whole society. Entrepreneurs and investors say it is time to digitize the public sector, especially in education, health and administration. This new normality will create many opportunities for future foreign investors in the Romanian technological ecosystem.

The automotive industry is one of the most affected sectors in Romania, which means that many investment opportunities are blocked in areas related to this sector. When the major car production centers in Romania were shut down due to Covid-19, as a result, at least 10% of the local economy was directly blocked, so that economic dependence is relatively high compared to this key sector.

The role that foreign direct investment has in stabilizing macroeconomic processes has been and is an important one. Their effects cannot always be fully exploited, certain key aspects are outlined where they must be acted upon permanently. In order to capitalize on the potential of foreign direct investment to stimulate and intensify the processes of development and sustainable economic growth, the following are considered as factors to increase efficiency: stimulating the attraction of higher technological FDI; stimulating the formation of innovative entrepreneurship, capitalizing on the economic opportunities created by membership of the European Union, maximizing the absorption of cohesion and structural funds and their efficient and effective use, contributing significantly to infrastructure development, ensuring sustainability of the long-term education and training system in order to make the workforce more flexible and dynamic.

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