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**Article**

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## FOREIGN DIRECT INVESTMENT AND THE ROMANIAN ECONOMY

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**Abstract:** *In a country's economy, investments take center stage, both in the production of goods and services and in the sphere of consumption. They represent a factor that influences simultaneously both demand and supply. The importance and impact of FDI have rightfully attracted all EU Members heed and resulted in a fierce competition for foreign capital. The purpose of this paper is to analyze the impact of FDI on Romania economic growth. Research results show that FDI have a positive impact through the medium of productivity and competitiveness growth in the host countries, by means of technology and capital transfer.*

**Keywords:** foreign direct investment, growth economy

**JEL Classification:** E22, F14, F43

### Introduction

Occurring in the world economy since the period of the great geographical discoveries, the direct foreign investments in the last few decades have been a veritable explosion in the international transactions, which has generated a surprising number of studies and analyses which have been dedicated. The investments with the participation of the foreign capital take the form of controversial, although, generally it is recognized the fact that they have a certain preponderance of their positive functions, especially at the level of the macrosystems (the national economy, the geographical areas etc.).

In Romania FDI contributes to the growth formation of the capital, in particular in the private sector and, at the same time, they have a beneficial role in putting into value the qualified manpower through the creation of new jobs. FDI constitute leverages for consolidation of international ties and the economic interdependence. This creates competitive advantages given by the volume of the exports on the world market, as well as the ability to generate drive effects on the adjacent industries (Anghel, 2002).

### 1. FDI – features

The issue of foreign direct investment and their influence on the economy continues to be a topic of interest for research and economic practice. Thus over time different definitions have been given to the concept of 'direct investment'.

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The Explanatory Dictionary of the Romanian Language defines the investment as a placement of funds, of equity in a company or a business (Opera, 2010).

Generally it can be accepted that any placement of funds in the economic, social, cultural, administrative, military, etc. to ensure regeneration or growth of the assets, labor coverage of the activities or promotion of organizations or businesses' goals is an investment (Zait, 2008).

United Nations Conference on Trade and Development defines foreign direct investment (FDI) as those investments that involve a long-term business relationship reflecting a lasting interest of an economic entity (direct investor or parent enterprise), as well as its control on an enterprise resident in a country other than that of the investor (UNCTAD, 2009).

The Organization for Economic Cooperation and Development considers as FDI those investments made in order to establish sustainable economic relations or exercise significant influence over the management of a business (OECD, 2010).

National Bank of Romania believes that foreign direct investment is a long term investment relationship between a resident entity and a non-resident entity, which usually implies that the investor exerts a significant influence on the management of the companies in which he invested (BNR and Institutul National de Statistica 2009).

For the International Monetary Fund, FDI is a category of international investment that reflects the purpose of an entity resident in a country (direct investor) to obtain a lasting interest in an enterprise resident in another country (direct investment). Lasting interest implies the existence of a long-term relationship between the direct investor and the company (International Monetary Fund, 2011).

Foreign direct investment (FDI) reflects the placement of equity by foreign investors (non-residents) in other countries for the establishment and development of companies in various fields. Foreign direct investment reflects foreign elements, represented by capital, land placement process, technological streams, knowledge, management, goods and services (Voinea, 2008).

In conclusion, FDI represents the relationship between a resident entity and a non-resident entity, usually - a long-term investment relationship and the investor has a significant influence or control.

## **2. The impact of FDI on economic growth**

The impact of FDI on economic growth and, respectively, on gross domestic, product was the subject of much research, which revealed a positive impact that foreign direct investment have on the economic growth in the host country. Firstly, the impact of FDI on economic growth manifests itself

differently depending on the type of foreign direct investment. In the case of a greenfield investment, economic growth achieved due to foreign direct investment is reflected by creating new production capacities, more jobs, more consumption among the population and increased revenue from contributions, taxes and fees.

In the case of FDI taking the form of privatization, it is mainly affected the technological process in the host country. Most of the times, in the case of foreign direct investments through privatization, this is followed by a refurbishment of the company. After retrofitting, foreign direct investments become a strong competitor on the market in the host country, thus motivating local Economic Agents.

FDI inflows hence stimulate domestic investment, as local producers will be motivated to improve the quality of goods and services produced in order to be competitive in the market. In many cases, foreign direct investors use raw materials, semi-finished auxiliary materials or services in the host country, thus having a positive impact on local companies.

For Romania, FDI have a very important role in the privatization process. Most privatizations after 1990 were made by foreign direct investments. Unfortunately, in Romania there have been negative experiences related to privatization through FDI. In some cases, after the privatization, foreign investors have decided to cease business activity, capitalized the assets and repatriated earnings. However, not all experiences were negative, the largest and most important companies in Romania today are companies belonging to foreign direct investors.

**Table 1 - Evolution of gross domestic product, of GDP per capita and FDI inflows in Romania during 1990-1995**

Indicators /Year	UNIT	1990	1991	1992	1993	1994	1995
Gross domestic product	Million Dollars	38.299	28.847	25.090	26.361	30.073	35.477
Gross domestic product per capita	Dollars /capita	1.651	1.254	1.101	1.158	1.323	1.564
Foreign direct investment	Million Dollars	0,01	40	77	94	341	419
Foreign direct investment stock	Million Dollars	0,01	44	122	215	402	821

Source: Data processed after the World Bank database and the United Nations Conference on Trade and Development, 2010 - 2011 (UNCTAD State), (<http://databank.worldbank.org/ddp/home>)

Gross domestic product is calculated as the difference between the total value of goods and services produced in a given period (gross global product) and the total value of intermediate

consumption (economic goods and services produced in order to obtain other economic goods and services). Gross domestic product is synonymous with the final product (Vasilescu and Romanu, 2003). GDP per capita is calculated by dividing the country's gross domestic product to the existing population, in the middle of the year, in the respective country and it is considered the most relevant indicator for measuring the economic growth of a state. Table No. 1 reflects the evolution of gross domestic product, of GDP per capita, of inflows and FDI stock in Romania for the period 1990-1995.

In 1990, the GDP was \$ 38.299 million dollars, registering a slight decrease in the following period, 1991-1992. The decrease in gross domestic product in 1991, 1992, is largely due to the political instability in the context of the 1989 revolution, after which Romania has undergone the transition from communist to democratic state. Gross domestic production 1990 was \$ 1,651 per capita. In the period 1991-1992, GDP per capita has decreased, following the evolution of gross domestic product.

In the period 1990-1993 there was an increase for foreign direct investments inflows, but their level remained low. In 1990, FDI inflows were \$ 0.01 million, increasing in two years' time to 77 million in 1992.

**Table 2 - Evolution of gross domestic product, GDP per capita and FDI inflows in Romania during 1996-2001**

Indicators /Year	UNIT	1996	1997	1998	1999	2000	2001
<b>Gross domestic product</b>	Million Dollars	35.334	35.286	42.116	35.592	37.053	40.181
<b>Gross domestic product per capita</b>	Dollars /capita	1.565	1.565	1.871	1.584	1.651	1.816
<b>Foreign direct investment</b>	Million Dollars	263	1,215	2,031	1,041	1,037	1,157
<b>Foreign direct investment stock</b>	Million Dollars	1.097	2.417	4.527	5.674	6.953	8.339

Source: Data processed after the World Bank database and the United Nations Conference on Trade and Development, 2010 - 2011 (UNCTAD State), (<http://databank.worldbank.org/ddp/home>)

In the period 1993 - 1998, all four indicators, namely GDP, GDP per capita, FDI inflows and FDI stock continued to rise. Gross domestic production 1998 reached a level of 42.115,49 million dollars, representing 10.74% of the gross domestic product of Romania in 1998. After 1997, as it can be seen from the data presented in Table No. 2, foreign investments inflow grew, recording higher values of over \$ 1,000 million dollars per year. The increase of annual FDI inflow led to the amplification of FDI stock, reaching nearly 5,000 million dollars in 1998.

In 1999 there was a slight decline in GDP and FDI inflow due to the global economic context. Gross domestic product per capita decreased in 1999, following again the development in GDP. FDI stock mended in 1999, reaching 5673.98 million dollars.

Since 2000, gross domestic product, GDP per capita, inflow and the stock of FDI in Romania have started to rise again. FDI inflow in 2000 was \$ 1.037.000 and the stock of foreign direct investment reached a value of \$ 8.339.000. The values recorded in 2000 for gross domestic product, GDP per capita and FDI inflow was very close to the values recorded in 1998, before the deductions of 1999. The FDI stock of 2000, 8.339 million dollars, was two times higher than the existing stock in 1998, of 4.527 million dollars.

**Table 3 - Evolution of gross domestic product, GDP per capita and FDI in flow in Romania during 2002-2007**

Indicators /Year	UNIT	2002	2003	2004	2005	2006	2007
Gross domestic product	Million Dollars	45.825	59.507	75.489	98.913	122.642	169.283
Gross domestic product per capita	Dollars /capita	2.102	2.737	3.481	4.572	5.681	7.857
Foreign direct investment	Million Dollars	1.144	1.844	6.443	6.482	11.393	9.925
Foreign direct investment stock	Million Dollars	7.846	12.202	20.486	25.816	45.452	62.961

Source: Data processed after World Bank data base and the United Nations Conference on Trade and Development, 2010 - 2011 (UNCTAD State) (<http://databank.worldbank.org/ddp/home>)

Increasing value of foreign direct investments stock illustrates the growing presence of foreign investors in the Romanian economy; their impact on the economy being more and more visible.

As shown in Table No.10, in the period 2002-2006, there was an increase in FDI, reaching the amount of 13.393 million dollars in 2006. The stock of foreign direct investments has increased due to entrance of FDI flows in Romania's economy. In 2003, the stock of foreign direct investments was of 12.202 million dollars, exceeding the value of 10.000 million dollars.

High levels of inputs and of the stock of foreign direct investments contributed to GDP growth and GDP per capita. Gross domestic product increased in the period 2002 - 2007, reaching a value of 169.283 million dollars in 2007, an increase of 269% compared to 2002. The GDP per capita also increased, reaching 7.857million dollars per capita in 2007.

From the analysis in the Ph.D. thesis, it results that 2002 – 2007 was a good period in terms of foreign direct investments impact in Romania's economy. Tax reforms in 2005 and Romania's

adherence to the European Union in 2007 has contributed to improving economic climate, having as effect also an increase in the stock of foreign direct investments. In turn, these factors, fiscal reforms, EU membership, increasing the stock and foreign direct investments inflow have contributed to GDP growth of Romania and GDP per capita, implicitly.

**Table 4 - Evolution of gross domestic product, GDP per capita and FDI inflows in Romania during 2008-2012**

Indicators /Year	UNIT	2008	2009	2010	2011	2012
<b>Gross domestic product</b>	Million Dollars	204.335	164.346	164.436	189.779	169.396
<b>Gross domestic product per capita</b>	Dollars /capita	9.497	7.651	7.670	8.874	7.943
<b>Foreign direct investment</b>	Million Dollars	13.883	4.846	2.940	2.523	2.242
<b>Foreign direct investment stock</b>	Million Dollars	67.910	72.008	70.264	71.344	74.171

Source: Data processed after World Bank database and the United Nations Conference on Trade and Development, 2010 - 2011 (UNCTAD State) (<http://databank.worldbank.org/ddp/home>)

Increased inflow of foreign direct investments and the stock of foreign direct investments level had an important role in GDP growth per capita. Through the positive impact that FDI have had on GDP and GDP per capita, it can be said that foreign direct investments have played an important role in the development of Romanian economy, contributing to the achievement of the emerging economy.

The global financial crisis of late 2008 caused panic among foreign investors worldwide. Foreign investors began to be more reserved since 2009. This retention global investors influenced the FDI inflow in Romania since 2009.

The decrease of FDI inflow in Romania was followed by a reduction in GDP and GDP per capita in 2009. The GDP per capita was of 7500.35 million dollars in 2009, a drop of 19.5% compared to 2008.

In the period 2009 - 2011, the inflow of foreign direct investments in Romania decreased due to the attitude of investors and the slowing down of FDI flows worldwide. In the years 2010, 2011 there was a slight increase in gross domestic product, with a value of 179.793.51 million dollars in 2010. Gross domestic product per capita also increases in the period 2010-2011, reaching 8.405,49 dollars per capita in 2011. However, in comparison with 2008, the level remained low.

While the FDI inflow was poor and continued to fall during the global financial crisis, in 2009 - 2011, respectively, the stock of foreign direct investments remained at a high level of over 70.000 million dollars every year. Due to the global financial crisis, due to decreased demand for goods and services worldwide, foreign investors reduced their activity. The high level of foreign direct

investments stock in Romania shows that this restriction of foreign investors activity in the world did not affect Romanian economy.

In 2011, the stock of foreign direct investments represented 39.12% of Romania's GDP, FDI continuing to positively influence Romania's economic growth. In 2012 there has been a decline of the FDI inflow and its level was reduced by 2.242 million dollars, far below the 13.883 million dollars recorded in 2007. The gross domestic product of Romania decreased in 2012 by 11% compared to 2011 and resulted in a decline in GDP per capita.

On the whole analyzed period, 1990 - 2012, gross domestic product and gross domestic product per capita have evolved in the same trends with the inwards and stock of FDI, that is, increased and decreased in the same periods, thus confirming the positive effect that increased FDI has on GDP. In Romania, foreign direct investments have played an important role in the modernization and economic development through the transfer of capital, technology and management.

### **Conclusions**

The impact of FDI on host economies is mostly a positive one, manifesting itself differently depending on the area and the region in which foreign investment is held. The impact of foreign investments on the host country depends largely on their quality and quantity. For the Romanian economy, by 2000, the level of foreign direct investments has been reduced. Foreign investors introduce in the host country, most often than not, new activities and technologies or upgrade the existing ones.

An important contribution of FDI on economic development of host countries is the transfer of technology, developed by physical assets or knowledge. FDI have a positive impact on foreign trade in the host country. Foreign direct investments do not lead to a replacement in trade flows, but to an enhancement of trade relations.

In addition to the direct impact that foreign direct investments have on foreign trade, they contribute to the restructuring of the national economy and local companies, both directly, for those who have ties to foreign investors, and indirectly, through increased competition between local firms and foreign affiliates.

Foreign direct investments have a direct impact on the generation of employment and unemployment. Working conditions and wages offered; including new skills acquired by local employees due to foreign investors also have a positive impact on the economy of the host country.



Moreover, FDI has a positive impact on the state budget by increasing state budget revenues due contributions, assessments and taxes paid by foreign direct investors in the economy of the host country.

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