



THE FOREIGN DIRECT INVESTMENTS AND THEIR ROLE WITHIN THE ECONOMIC CRISIS THE CASE OF ROMANIA

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Rezumat

Principalul obiectiv al acestui articol este de a evidenția importanța investițiilor directe în vederea creșterii economice, în special în contextul actualei crize economice. Analizele prezentate pentru economia României, fundamentate pe o serie de indicatori macroeconomici relevanți, aferenți perioadei 1990-2007, demonstrează că, fără o creștere semnificativă a investițiilor de capital, susținută și de către stat, plin aplicarea unor măsuri concrete, refacerea economiei românești va fi un proces dificil.



Abstract

This paperwork main objective is to put into limelight the importance of direct investments for economic growth, especially in the context of economic crisis. Based on the most relevant macroeconomic indicators for the period 1990-2007, at the level of Romanian economy, the analysis presented in this article, demonstrate that, without a significant development of capital investments, sustained by state through active measures, the Romanian economy recovery will be a very hard process.

Keywords: direct investments, economic growth, economic crisis

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General considerations

The modernization and, implicitly, development of the national economy can not be done without direct investments, that is, without that category of financial investments in the real economy, which is the “material support of the economic growth in any country worldwide” (Vasilescu, Romănu and Cicea, 2000, p.13).

Practically, there are many effects of the direct investments at the microeconomic level, materialized essentially in (Iacovoiu, 2009, p.175-176):

- *Job creation*, which is one of the most important effects of the “greenfield investments”. Although the number of jobs created by the direct investors is of particular importance, in terms of long-term economic effects, job quality is more important than job number.
- *Better training of the labour force*, when the companies invest in activities which require a high training of the employees. In this situation the investors will pay more and continuous attention to staff training. The acquired knowledge can be spread if the employees of these companies move to other companies or if they start their own businesses.
- *Access to modern technologies*, considerable advantage for the firms which use worn out and outdated equipment producing low quality products and low yields. Because the direct investment presumes the transfer of advanced technologies, modern production techniques and know-how, the beneficiary enterprise will increase its performance in terms of production and quality, which will improve its competitiveness for export. The infusion of technology may also generate local driving effects by stimulating innovation or by diffusing the modern technologies in companies other than those in which the investment was done.
- *Higher efficiency and competitiveness of the beneficiary companies*, which will be able to improve the quality of their products and diversify their production by using the new technologies, by implementing modern production processes, by improving staff training etc.

By the direct and indirect positive effects generated at the microeconomic level, the investments support the development and modernization of the entire national economy via the two-way relation between the direct investments whose main traits are their volume and quality, and the economic growth. Furthermore, at the macroeconomic level, the beneficial influences are also materialized in the performance of other significant parameters such as the commercial deficit and the budget deficit. If the direct investor produces mainly for the export or for the domestic market in order to substitute the imports, the impact on the commercial balance is positive. By the establishment of new tax payers in the economy, the “greenfield” investments support the increase of the revenue to the state budget (Iacovoiu, 2009, p.149-150).

In consequence, the direct investments are the “drive” for the economic revival. Following is an analysis of several indicators representative for the evolution of the evolution and impact of the direct investments in Romania during 1990-2007.

Direct investments in Romania during 1990-2007

In the spirit of a rigorous approach and taking into consideration the theoretical aspects shown above, we will survey the effects generated both at the microeconomic, and at the macroeconomic levels.

Impact of the direct investments at the microeconomic level

We will start by presenting the influence of the direct investments on the productivity, efficiency and competitiveness both at the national level (RO) and at the level of the branches that hold a quite high proportion within the overall economic activity: *industry* (I) with sub-branch *processing industry* (PI), *commerce* (C), *transportation, storage and telecommunication services* (TST) and *financial intermediation* (FI).

We will analyse several specific rates:

- *Rate of investments* (Rinv) - table 1;
- *Technical endowment* (TE) expressed in million RON, comparable prices per employee - table 2;
- *Work productivity* (W) expressed in million RON, comparable prices per employee - table 3;
- *Rate of GAV* within the manufactured production (Rgav) - table 4;

- *Rate of exports* within the manufactured production (Rexp) - table 5.

Table 1

Rate of investments, 1990-2007 (percent)

Sector of activity	1990	1995	2000	2004	2007
RO	21.37	19.52	17.58	20.61	23.58
I	22.44	22.79	22.51	31.32	39.45
PI	11.24	15.66	18.16	24.08	29.21
C	8.16	14.83	16.85	28.51	46.11
TST	45.55	19.35	28.71	21.49	18.36
FI	0.87	13.16	45.15	37.35	31.02

Source: Iacovoiu V.B., 2009, p.357

Table 2

Technical endowment, 1990-2007
(million RON, comparable prices per employee)

Sector of activity	1990	1995	2000	2004	2007
RO	0.020	0.023	0.024	0.042	0.059
I	0.020	0.022	0.024	0.044	0.062
PI	0.010	0.015	0.018	0.034	0.048
C	0.007	0.015	0.022	0.044	0.073
TST	0.031	0.022	0.056	0.072	0.078
FI	0.005	0.075	0.071	0.088	0.092

Source: Iacovoiu V.B., 2009, p.354

Table 3

Work productivity, 1990-2007
(million RON, comparable prices per employee)

Sector of activity	1990	1995	2004	2007
RO	0.26	0.26	0.44	0.48
I	0.32	0.29	0.44	0.48
PI	0.31	0.29	0.40	0.41
C	0.12	0.14	0.23	0.24
TST	0.13	0.20	0.54	0.66
FI	0.64	0.68	0.44	0.50

Source: Iacovoiu V.B., 2009, p.353

Table 4

Rate of GAV, 1990-2007 (percent)

Sector of activity	1990	1995	2000	2004	2007
RO	37.7	44.4	46.3	47.0	51.7
I	27.9	32.9	33.5	33.7	33.0
PI	29.3	32.4	33.7	35.0	39.8
C	68.9	72.5	66.0	63.1	66.8
TST	53.1	57.3	58.5	58.0	64.0
FI	94.7	84.7	68.2	67.4	58.8

Source: Iacovoiu V.B., 2009, p.356

Table 5

Rate of exports, 1990-2007(percent)

Sector of activity	1990	1995	2000	2004	2007
RO	6.19	10.81	14.73	15.52	21.79
I	10.01	21.76	33.63	39.82	56.15
PI	11.50	26.34	41.88	50.41	74.04

Source: Iacovoiu V.B., 2009, p.355

The dynamic analysis of these rates for the period 1990-2007, using fixed based indices (1990 = 100), revealed their evolution at the national and sectoral level, showing the increases or decreases over the span of 18 years, as the direct investments, local and foreign, were done in the economy (Table 6)

Table 6

Dynamics of the economic rates, 1990-2007
(+/- percent points)

Sect. of activ.	1995/1990					2000/1990				
	W	TE	Rinv	Rgav	Rexp	W	TE	Rinv	Rgav	Rexp
RO	+0	+15.0	-8.65	+17.8	+74.6	+15.4	+20.0	-17.7	+22.8	+137.9
I	-9.4	+10.0	+1.56	+17.9	+117.4	-3.12	+20.0	+0.32	+20.08	+235.9
PI	-6.5	+50.0	+39.3	+10.6	+129.0	-3.22	+80.0	+61.6	+15.02	+264.2
C	+16.7	+114.3	+81.74	+5.23	-	+66.7	+214.3	+106.5	-4.15	-
TST	+53.8	-29.0	-57.5	+7.9	-	+153.8	+80.7	-36.9	+10.2	-
FI	+6.25	+1400	+1413	-10.6	-	-64	+1320	+5090	-27.98	-

- continued -

Sect. of activ.	2004/1990					2007/1990				
	W	TE	Rinv	Rgav	Rexp	W	TE	Rinv	Rgav	Rexp
RO	+69.2	+110	-3.6	+24.7	+150.7	+84.6	+195	+10.3	+37.1	+251.6
I	+40.6	+120	+39.6	+20.8	+197.8	+50.0	+210	+75.6	+18.3	+456.4
PI	+29.0	+240	+113.5	+19.6	+338.4	+32.3	+380	+159.8	+35.8	+543.5
C	+91.7	+528.6	+249.4	-8.5	-	+100.0	+942.8	+465.1	-3.1	-
TST	+315.4	+132.3	-52.7	+9.3	-	+407.7	+151.6	-59.7	+20.7	-
FI	-31.3	+1660	+4193	-28.8	-	-21.9	+1740	+3466	-38.3	-

Source: Iacovoiu V.B., 2009, p.358-359

In the sector of the *processing industry*, throughout the survey interval, the rate of investments was higher than the basic rate (1990), which improved the technical endowment, with positive effects on the reduction of the specific consumptions, which allowed the achievement of a plus of gross added value. However, during the first 10 years, the modernization of the activity due to the higher technical endowment didn't show in the work productivity, which decreased by 8.5% in 1995 (compared to 1990) and by 3.22% in 2000. The persistence of higher rates of investments (increases of 39 to 93% compared to 1990) throughout the surveyed interval was, in our opinion, the main source for the modernization of this sector of activity. The improved technical endowment and the efficient allocation of the human resources were the driving factors for the increase in the work productivity. The advanced technology and the knowledge transferred together with this technology allowed the decrease of the specific consumptions (material expenditure) and the increase of the rate of GAV within the manufactured production. Thus, in 2004 compared to 1990, productivity in the processing industry increased by 29% and the added value, as proportion within the production, increased by 19.6%, trend which was even more marked during the subsequent years, so that in 2007, the increase of

productivity was 32.3%, with much lower material expenditure (Rgav increased by 35.8% compared to 1990). In consequence, the investments in the processing industry supported, directly and indirectly (through driving effects), the modernization and technologization of the production activities, with beneficial effects on the work productivity, efficiency of the activity (lower material expenditure and increase of GAV rate within the manufactured production) and of the competitiveness.

The massive investments, which displayed a consistent increasing trend throughout the surveyed period, supported the strong development of the *commerce* sector, dominated currently by the large foreign networks of shops. As the commercial activities developed, and the profits increased, as did their proportion within the gross added value under the conditions in which, starting with 1995, on the background of a stronger increase of the manufactured production compared to the GAV, this sector was confronted with a decrease of the rate of the gross added value compared to 1990. This diverging evolution of the surveyed rates is explainable if we take a look at the history of this sector of activity. Thus, in 1990, the investments were modest and the services were of low quality and diversity (traits inherited from the communist period), while GAC rate was high (about 69%). This situation was preserved during the immediately subsequent years, on the background of higher investments and higher rates of work productivity. The arrival of the foreign capital produced changes in the mentality of the entrepreneurs in this field of activity and a new business culture developed oriented towards customer satisfaction. At the same time, the increasing competition required additional investments and higher expenditure for the development of the distribution networks and for promotion (advertising). Within this context, the proportion of GAV within the achieved production (turnover) decreased severely, the main beneficiaries being the customers, which benefited from a higher quality and diversity of the products and services on sale.

After 1990, the *services of transportation, storage and telecommunication* developed strongly, including with the support of the foreign investors which targeted preponderantly the telecommunication services, poorly represented during the previous period and dominated currently by the foreign companies. The analysis of the empirical data shows that after 1995, when the foreign

investors joined this sector of activity, although the rate of investments was lower than the rate from 1990 (because of the stronger increase of GAV than of the value of achieved investments), the level of technical endowment improved continuously, with positive effects on work productivity and efficiency. Thus, in 2007 compared to 1990, on the background of the modernization of the activity and of a proper staffing of the services, the productivity increased dramatically (407%), while GAV rate increased by 20.7%. In consequence, the direct investments supported the modernization of this sector and the development of new activities (in telecommunications), thus generating a significant increase of work productivity and efficiency.

The services of *financial intermediation* showed the strongest increase of the rate of investments, 14 to 50 times more than in 1990, with a positive impact on the technical endowment which increased between 1400 and 1660% compared to 1990. Therefore, this sector developed strongly largely due to the foreign investors which either bought existing companies (during the process of privatization) or developed greenfield investments. The empirical data show that the financial intermediation developed simultaneously with a loss productivity and added value. Thus, in 2000 compared to 1990, work productivity decreased by 64% and the rate of the gross added value decreased by about 28%. Although after 2000, together with the arrival of new competitors on the market, the negative trend of the work productivity reversed and started to grow, in 2004 it still was 31% lower than in 1990. At the same time, GAV rate decreased slightly compared to 2000 to 28.8%. In 2007 compared to 1990, the work productivity was 22% lower and the rate of GAV within the achieved production was about 38% lower.

Impact of the direct investments at the macroeconomic level

The positive and negative effects generated at the microeconomic level reflected directly and indirectly on the evolution of the Romanian economy, the intensity of the impact increasing with the volume of the direct investments starting with 2000 (Table 7).

Table 7

Evolution of the main macroeconomic indicators, 1990-2007

INDICATOR	1990	1995	2000	2004	2007
GDP (billion RON)	0,09	7,21	80,40	246,40	372,3 ²⁾
Gross investments (billion RON))	0,017	1,30	12,50	44,87	98,58 ³⁾
Investment rate (% of GDP)	18,89	18,03	15,55	18,21	26,48
FBCF (billion RON))	0,017	1,54	15,19	53,22 ⁴⁾	95,31 ⁴⁾
FOB imports (billion RON))	0,018	1,96	26,52	98,26	144,4 ⁵⁾
FOB exports (billion RON))	0,014	1,62	22,64	76,79	102,9 ⁵⁾
Trading deficit (billion RON))	-0,004	-0,34	-3,88	-21,47	-41,51
Revenue to the budget (billion RON))	0,02	1,29	12,04	32,19	66,43
Budget expenditure (billion RON))	0,02	1,59	14,92	34,07	68,15
Budget deficit (billion RON))	0	- 0,30	- 2,88	- 1,88	- 1,72
Unemployment rate (%)	3,0	9,5	10,5	6,3	5,8

Source: Iacovoiu V.B., 2009, p.342-343

The lack of means to replace the imports of technology and the accessories for industry and the orientation of the investors preponderantly towards the domestic market influenced adversely both the volume and the structure of the Romanian imports: the imports for technology (required to implement the investments), components and accessories for industry increased. The preponderant orientation of the investors towards the work-intensive branches to the detriment of the branches based on advanced technology and knowledge, determined the increase of the export of low processed goods (metal, timber, glass, furniture, textiles, garments etc.). The stronger dynamics of the imports compared to that of the exports and the unfavourable structure of the commercial flows increased the deficit of the commercial balance.

As the volume of the direct investments in economy increased, the effects at the microeconomic level reflected in the budget deficit.

Thus, the increasing flows of direct investments largely towards “greenfield” investments supported the increase of the budget revenue by additional taxes and due paid by the new taxpayers, by the economic agents and employees. Furthermore, by driving effects, the matured investments contributed to the development of activities on the vertical and/or horizontal, influencing indirectly, positively and significantly, the budget revenue.

These analyses confirm and support the conclusion that the direct investments, by their trait of novelty, generate the modernization of the economic activities. In the case of Romania, the local and foreign direct investments played an essential role by supporting the economic growth, their intensity and final impact being directly proportional to the volume and structure of the flow of investments.

The current context in Romania

According to European Commission data on GDP growth, in the first quarter of 2009 compared to the same period of the previous year, the rate of GDP growth was 5.7% lower in Romania versus 4.7% in EU27. During the same period, the unemployment rate increased by 19.6% in Romania, more than 1% higher than in EU27 (18.3%). (Eurostat newsrelease 100/2009 – July 8, 2009 and 109/2009 – July 23, 2009).

Comparatively, the National Commission for Prognosis (NCP), starting from the prognosis of a rate of real GDP growth of -4%, in 2009 and 0.1%, in 2010, an inflation rate of 5.8%, in 2009 and 3.5%, in 2010 and an exchange rate RON/euro of 4.25, for 2009 and 4.20, for 2010, forecasts the following evolution of the main macroeconomic indicators in 2009-2010 (Table 8).

Table 8

Evolution of the main macroeconomic indicators, 2009-2010

INDICATOR	2009	2010
Contribution of the industry to GDP change (% compared to previous year)	-10,00	-3,00
Contribution of the agriculture to GDP change (%compared to previous year)	-2,90	0,80
Contribution of the constructions to GDP change (%compared to previous year)	2,60	4,00

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Contribution of the services to GDP change (%compared to previous year)	-2,20	0,70
FBCF (%compared to previous year)	-6,50	-0,50
Trading deficit (%compared to previous year)	-8,30	-7,40
End consumption (%compared to previous year)	-8,30	-7,40
Real wage income (%compared to previous year)	-1,9	0,0
Unemployment rate (percent)	6,8	6,4

Source: NCP „Projection of the main macroeconomic indicators for 2009-2013”, 28 April 2009

The National Bank of Romania (NBR) showed that the current account of the payment balance displayed a 709 million deficit in the first quarter 2009, 82.1% lower than in the similar period of 2008, particularly due to the reduction of the commercial balance deficit – 1337 million euro, 67.2% lower than in the first quarter of 2008. Compared to the first quarter 2008, when 42.8% of the current account deficit was financed by direct investments of the non-residents in Romania, in the first quarter 2009 it was fully financed by the direct investments of the non-residents in Romania: 1456 million euro (compared to 1691 million euro in the first quarter 2008). Of the 1456 million euro, the participation to capital represented 50.8%, the intr-group credits represented 39.9% and the reinvested profit represented 9.3%.

According to NBR, at June 30, 2009, the non-governmental credit increased by 5.0% in real terms compared to June 30, 2008, mainly due to the increase of the foreign currency component expressed in RON (expressed in euro, the increase of the foreign currency credits was 3.5[^]). Also, compared to June 30, 2008, at June 30, 2009, there was a 14.2% increase (real terms) of the households deposits in RON, while the deposits in RON of the legal persons (non-financial companies and non-monetary financial institutions), expressed in euro, increased by 0.5% (expressed in RON the increase of non significant, 0.1%).

The empiric data above show the current action of several adverse effects due to the contraction of the Romanian economy (stronger than the EU average), such as:

- Significant contraction of the industrial activity;
- Strong decrease of the direct investments, including of the foreign direct investments, with an adverse impact on the gross formation of the fixed capital;
- Higher unemployment rate and lower real income from wages; lower inflation.

Conclusions

These analyses reveal the importance of the direct investments for the economic revival, also showing the need to unblock the financing of the economic activities from drawn funds, reimbursable and non-reimbursable credits. This is why a major problem under the conditions of the current financial crisis is, in our opinion, the credit for investments. Currently, the volume of credits for productive investments is very low and the cost of the loaned capital is much too high. Under this context, the banking system doesn't fulfil its main purpose, which is to allocate efficiently the available resources of the society.

The unblocking of direct investments financing is just an aspect of the problem. The financial resources, limited because of the economic crisis, must be imperatively directed towards objectives with major impact on the economy which will generate both directly and indirectly towards relaunching the economic activities. The economic theory and practice show undoubtedly that the influence of the direct investments on the economic growth is largely determined by the quality of the investments.

In consequence, the state by its decision-makers plays an important role for the economic relaunching through punctual measures based on criteria of efficacy and efficiency. Although NCP prognoses are optimistic in our opinion (they show just a 4% decrease of the GDP for 2009), we consider that in the absence of a coherent and clear plan of action which to stimulate, among other, the stimulation of investments by loosening the pressure on the economic agents, the Romanian economy may be confronted with even worse effects.

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