# The Influence of Foreign Direct Investments on Business Environment in Romania

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***Abstract:*** *Europe remains one of the attractive world's regions for investment due to workforce highly skilled, rule of law and the existence of an integrated single market. Europe is the region that attracts most foreign direct investment. The level of investment in the EU has dropped significantly, but can see variations from country to country, both in terms of private investment and public investment. Investments in Romania had a downward trend. Obstacles to foreign investment include difficult access to finance often associated with poor insolvency frameworks, the challenges of an administrative nature (regulatory burden or lack of predictability of regulation) and low capacity of response of the labor market.*

***Key-Words:*** foreign investment, public finance, public investments, economic developments, gross domestic product (GDP)

## 1. Introduction

The domestic economy has felt the effects of the international financial crisis, although their intensity managed to be somewhat tempered by a series of measures taken by the Romanian authorities in terms of macroeconomic and financial stability: 1) conclusion of multilateral financing agreement with the European Union, International Monetary Fund and World Bank, 2) materialization of commitments under the European Bank Coordination initiatives, financial deleveraging commitments prevented disorderly or excessively rapid or strengthened cooperation between supervisors; 3) issue directives to the central bank's prudential plan, which focused banking system intensified efforts provisioning, capital adequacy and stricter regulation lending in foreign currency, in accordance with the recommendations of the European Systemic Risk Board.

The observed evolution in the real economy and financial crisis with international submissions are well founded so conventional theory and by historical precedent. Accelerated increases in asset prices, anchored by optimistic expectations regarding future capital gains that have coexisted with alert credit expansion were followed by severe financial crisis and economic recession deeper and longer. The main obstacles to investment are often related to unpredictability, complexity and the heavy burden of the regulatory framework, the lack of transparency of public administration, the judiciary and tax system and often the difficulties of getting access funding.

Potential obstacles to investment are classified into five categories:

- government / business;
- employment / education;
- the financial / taxation;
- research, development and innovation;
- regulation sector (business services / regulated professions, retail, construction, digital economy / telecommunications, energy and transport).

A negative aspect is that funding opportunities from sources both national and international are underutilized. Investments financed exclusively from national resources represent 9 percent of total public expenditure or 2.6 percent of GDP.

## 2. Investment implications on business environment

Funding sources for investment are funds from the state budget, structural funds and loans from international financial institutions such as the European Investment Bank and European Bank for

Reconstruction and Development. Domestic banking sector is the main financier of the authorities, approximately 70 percent of the bonds they hold Romanian financial system is in the banks' portfolio.
Public investments are still supported largely by funds from the EU. Romania has the second lowest level of public investment between countries with similar characteristics and is the only country where public investment has declined every year since 2008.

Managing public investment is affected by the lack of defining priorities and lack of coordination. Overall, government capacity affects the business climate, public investment and delay causes a decreased absorption of public funds.

Public investment in Romania fell, although there are various sources of funding. In 2013, investment accounted for almost 24% of GDP, compared to 19% of GDP in the EU and public investment accounted for approximately 20% of total investments (or 5% of GDP).

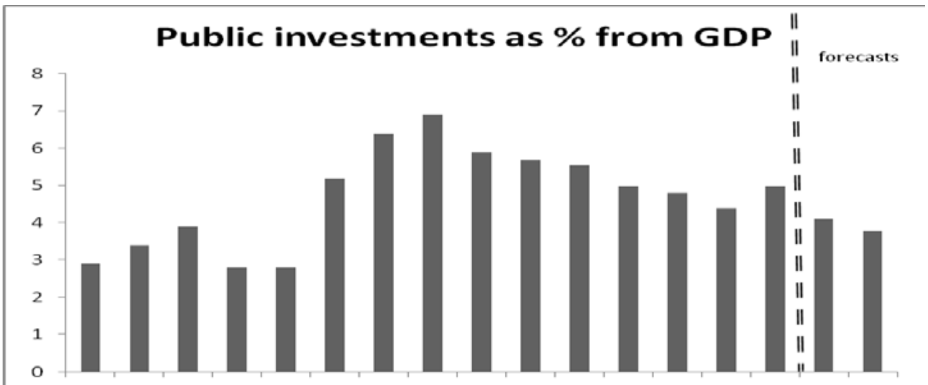
In 2014, public investment in Romania accounted for 4.3 percent of GDP. The percentage of public investment is still above the pre-accession period, but below the record level of 6.7 percent of GDP in 2008.

Investments in national economy shows a historic low recorded in 2014 of 65.5 billion lei, down compared to 2013. For comparison, investments in the national economy in 2008 amounted to 90 billion lei, up by 17.1 % compared to 2007.

In 2015 Romania has allocated an amount of nearly 17 billion lei for public investment, which meant the equivalent of 2.3% of GDP. Most of the funds allocated by the principal public investment was focused on the financing and completion of the investment objectives and we continue with multiplier effect and direct contribution to gross fixed capital formation (50.2% of spending over investment total sources, namely over 57.3% of investment costs allocated from the state budget)

In 2016 investment spending was totaling 37.7 billion lei, representing approximately 5,1 percent of GDP and their share in total budget expenditure of 14.9 (script no. 10). For 2017 they are estimated at 37.7 billion lei in 2018 valuation stands at 44.7 billion lei and a share of GDP and 5.3 percent of GDP in 2019 was estimated 47.2 billion lei, respectively 5,2  percent of GDP, an upward trend in nominal horizon from 2016 to 2019, increasing in 2019 to 9.5 billion lei in 2016, according to MPF.

**Graphic no. 1**

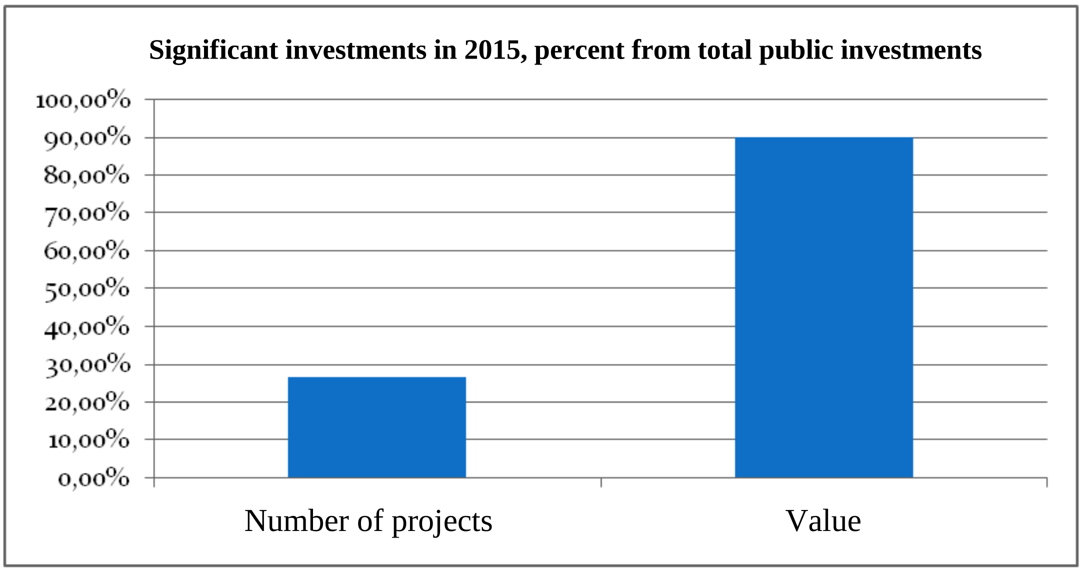



Source: BNR, Financial Stability Report, 2016

Investments help the increasing of business profitability. Attracting and efficient allocation of capital flows (especially in the form of high quality investments) constitutes the main driver of growth in the medium and long term GDP. In this way, it facilitates the private sector access to finance investments, encourage technology transfer and innovation, promotion of technology parks and business incubators, stimulating innovation and entrepreneurship, supporting women entrepreneurship, growth private companies and labor productivity, and practices management based on the principle of investing in people.

Effective mobilization of investment resources contributes to increased industrial production, improving complex national economy, tackling the problems of refurbishing the enterprises, but also to the sustainable development of regions.

**Graphic no. 2 the amount of significant investments in 2015**




Source: Ministry of public finances, Report on analysis of existing portfolio of public investment projects, 2015

For 2016, the Ministry of public finances started implementing mechanisms for transparency and efficiency of public spending that will contribute to increase fiscal space for investments, improving the sustainability of public finances in the medium and long term, increasing absorption capacity of European funds and increase the predictability of budgetary policy medium term.

The action consists in analyzing the sector of public spending, to prioritize and streamline their allocation, identifying ways of achieving savings in various items of expenditure and development of sectorial strategies spending proposals.

Principles on which public investment projects are evaluated in the prioritization process are: opportunity of investment project in the context of sector strategies or national economic justification and its social, affordability and financial sustainability arrangements for implementation / performance implementation and the remainder until the completion of public investment project (for further public investment projects).

## 3. Foreign direct investment in Romania

Investment relationship on a long term between a resident entity and a non-resident entity, which usually implies that the investor exerts a significant influence in the management of the investee company, is foreign direct investment.

Are considered FDI investment capital: share capital and reserves due to a foreign investor who owns at least 10 percent of the vote or the subscribed share capital of a company resident credits the investor or group to which it belongs and company in which he invested and reinvested earnings this, loans from companies resident whose voting power or share in the company's share capital resident is under 10 percent, but are part of a direct investor in resident company in question (sister companies).

Non-residents' direct investment in Romania amounted to 2.036 million Euros of equity stakes (including reinvested earnings estimated net) amounted to 1.561 million Euros and recorded net intergroup loans of 475 million Euros in the first half of 2016.

According to the National Trade Register Office (NTC), the number of newly established companies with foreign capital in the first six months of 2016 decreased by 12 percent compared to the same period last year, to 2,687 companies.

The total amount of the share capital of 2.687 new companies is 19.72 million dollars. Most companies were set up in March, 509 respectively, 17.7 percent fewer than the same month of 2015.

At the end of June, the number of companies with foreign participation in the capital of Romania was 207.153; the total capital is over 43.4 billion Euros.

According to NTC, 2015 Romania recorded the lowest number of newly established companies with foreign capital in 18 years.

In the table below are presented on the principle directional direct investment. Directional principle is that it follows the relationship between the investor direct investment and foreign direct investment company (claims on non-resident investors of these companies are recorded as decreases / withdrawals FDI).

**Table no. 1. Direct investment on directional principle**

*Netto mil. Euro*

| Components | 2015 (January - July) | 2016 (January - July)* |
|---|---|---|
| **Residents investments abroad** | - 316 | - 130 |
| Companies that accept deposits, excluding central bank | -2 | -0 |
| Equity, including reinvested earnings | -2 | -0 |
| Debt instruments | 0 | 0 |
| Other sectors | - 314 | - 129 |
| Equity, including reinvested earnings | 109 | - 3 |
| Debt instruments | - 423 | - 126 |
| **Non residents investments in Romania** | 2 153 | 2 339 |
| Companies that accept deposits, excluding central bank | 94 | 369 |
| Equity, including reinvested earnings | 91 | 375 |
| Debt instruments | 3 | - 5 |
| **TOTAL** | 1 837 | 2 210 |

*) provisional data Source: BNR, 2016

Between 1991 – 2015, 204 466 companies were founded by foreign capital, the total subscribed share capital to over 42.8 billion Euros, predominantly construction companies (accounting for 27.2 percent), industry (25, 9 percent) and professional services (19.3 percent). Most such companies were established in Bucharest, respectively 92 072 (total amount of share capital - 21.9 billion Euros).

Of the 204 466 companies, 41 749 Italian firms have capital, but the most valuable capital is a Netherlands company, namely 8.4 billion Euros, although about 4,600 companies.

Most Foreign Direct Investments in Romania are from the EU in terms of share of total FDI ranking of 31 December 2015 is as follows: Netherlands (25.0 percent), Austria (14.2 percent), Germany (12, 4 percent), Cyprus (6.9 percent) and France (6.7 percent).

The size of FDI in Greenfield enterprises, order their own countries differ in part by the order determined by the total balance of FDI origin. Thus, the biggest Greenfield investment in enterprises came from the Netherlands (21.5 percent), followed by Germany (16.9 percent), Austria (11.2 percent) and 7.6 percent in Italy FDI in Greenfield enterprises.

**Table no. 2. Distribution by countries of origin of FDI 31 December 2015**

| Distribution by countries of origin of FDI 31 December 2015 | | |
|---|---|---|
| | **Value (mil. Euros)** | **Share in total FDI (percent )** |
| **Holland** | 16 100 | 25,0 |
| **Austria** | 9 131 | 14,2 |

| | | |
|---|---|---|
| **Germany** | 7 991 | 12,4 |
| **Cyprus** | 4 421 | 6,9 |
| **France** | 4 308 | 6,7 |
| **Italy** | 3 349 | 5,2 |
| **Luxemburg** | 2 700 | 4,2 |
| **Switzerland** | 2 231 | 3,5 |
| **Greece** | 1 747 | 2,7 |
| **United States of America** | 1 627 | 2,5 |
| **Belgium** | 1 444 | 2,2 |
| **Spain** | 1 423 | 2,2 |
| **Great Britain** | 1 346 | 2,1 |
| **Hungary** | 938 | 1,4 |
| **Czech Republic** | 652 | 1,0 |

Source: BNR, Financial Stability Report 2016

In 2014 net Foreign Direct Investments flows reached the level of 2421 million, structured as follows: contribution to the equity of foreign direct investors in direct investment enterprises in Romania worth 2846 million. The contribution from equity consists of ownership interests in FDI enterprises, worth 4222 million, plus reinvested earnings, the negative amount of 1376 million.

For 2014 FDI were directed to manufacturing (929 million euro) and in its main branches recipient of foreign direct investment were transport (411 million euro), manufacture of computer, electronic products, electrical and optical (EUR 168 million) and metallurgy (158 million); Other sectors with significant investments were construction and real estate (646 million euro), information technology and communications (253 million Euros) and trade (€ 225 million).

Foreign Direct Investments were located mainly in manufacturing (32.0 percent of the total balance FDI). And within this industry branches: petroleum, chemicals, rubber and plastic products (5.7 percent of the total balance FDI), transport industry (5.4 percent), metallurgy (4.5 percent ), food, beverages and tobacco (4.0 percent), cement, glass, ceramics (2.6 percent) and manufacturing of wood products, including furniture (2.5 percent).

Besides industry significant FDI activities that are financial intermediation and insurance (representing 13.0 percent of total FDI), wholesale and retail trade (11.7 percent), construction and real estate (9.8 percent), information technology and communications (6.0 percent). At the end of 2014 tangible and intangible assets recorded a balance of 30 883 million euro, representing 51.3 percent of total balance of FDI, which indicates a considerable degree of foreign investment.

In 2014 the Greenfield investment and mergers and acquisitions category registered a low of 77 euro 196 million respectively; the preponderance in the flow of shareholdings in 2014 is the restructuring of companies with a value of 2438 million or 58 percent of equity, and development companies with 1511 million, representing 36 percent of holdings.

To assess the lasting impact of Greenfield investment on the economy were highlighted and accumulation of foreign direct investment (stocks) in enterprises established as Greenfield investments, called Greenfield enterprises. Foreign direct investment in Greenfield enterprises, are amounting to 32 527 million, representing 54 percent of total balance of FDI.

Net inflow of FDI in 2015 was driven primarily trade (1,000 million Euros) and for financial intermediation and insurance (926 million Euros). The manufacturing industry also benefited from a major influx of FDI (euro 745 million); within its main activities recipient of foreign direct investment were transport (532 million euro), oil processing, chemicals, rubber and plastics, and machinery and equipment, each with 183 million Euros each, and manufacture of computer, electronics, optical and electrical 133 million.

Business activities where FDI is reflected in tangible and intangible assets to a significant degree are: industry (26.6 percent of total FDI) (in its manufacturing owns 18.7 percent of total FDI), construction and real estate transactions (6.1 percent) and trade (6.0 percent).

Besides industry significant FDI activities can be count on financial intermediation and insurance (13.1 percent of total FDI), trade, and construction and real estate, both being by 12.2 percent of total FDI, and activities professional, scientific, technical, and administrative and support services (6.3 percent of total FDI).

## 4. Conclusions

Attracting FDI in the economy is a competitive activity both globally and regionally. The efficiency of foreign investment must necessarily be reflected in the creation of production capacity of goods and services, creating new jobs and of course, the actual contribution to increasing the stock of inputs.

The financial crisis has revealed in particular that imbalances in financial markets as excessive increase in the pace of credit indebtedness across all sectors of the economy, asset prices can coexist with low and stable inflation. The analysis of foreign direct investment is justified by the fact that they are seen as the main factor stimulating economic growth.

Attracted investments should be directed towards those economic sectors that contribute to sustainable economic growth - agriculture, tourism, and manufacturing - and not for speculative sectors such as real estate or retail.

Based on these aspects we concluded that the development of the SME sector by facilitating its access to financing creates the prerequisites for economic growth and social sustained by creating new jobs and ensuring a level of development that is appropriate for the individual and society.

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