DETERMINANTS OF FOREIGN DIRECT INVESTMENT DEVELOPMENT

Elena Chirila - Donciu*

Abstract: *FDI had a strong impact in the last three decades on economic growth, foreign trade and production structures in almost all countries. The purpose of this paper is to analyze the main factors that contribute to attracting foreign direct investment flows and also the competitiveness of the business environment in Romania and its implications on investment decisions and economic growth. Research results show that the presence of FDI goes to those areas that can provide efficiencies investment factors: skilled and qualified labor, educational and research institutions etc..*

Keywords: foreign direct investments; economic growth
JEL Classification: E22; F43; P33

INTRODUCTION

Throughout time, there has been a diverse and continuous evolution of the ways to develop a business beyond the country of origin from the traditional ones, centered on export, to more complex ones, leading to today's concept of foreign direct investment. The development of mankind nowadays known results from an ongoing process of investment in various forms. The different ways to invest, as well as the effectiveness of investments measurement have been the subject of discussion ever since the beginning of economic science, reaching today a great significance because of the development dynamics and economic growth, the major inequities given by the information asymmetry in terms of current states.

Investment is the material support of socio-economic development of the country. They underlie the refill, diversification and qualitative growth of all factors of production. The increase of fixed or working capital, of technical and economic efficiency of machinery, of the labor productivity, of new jobs, the diversification of production cannot be achieved without financial resources consumption, without investment. In this context, investment is the decisive element of economic growth, the promotion of intensive quality and efficiency factors. Foreign investment will complete the necessary internal resources and develop competitive factors of production.

* Alexandru Ioan Cuza University of Iasi, email: ecdonciu@yahoo.com.

1. FACTORS DETERMINING THE SIZE OF FOREIGN DIRECT INVESTMENT

In a globalized, open world, investment demand depends only on the existing investment potential, companies looking for opportunities wherever these opportunities may be. What determines the development of this process does not have to do only with the interest or desire of these companies to make themselves known, but the presence of factors of attractiveness in the world. The process is, by nature, a bilateral one. The first component and, in fact, the support of the way of involvement in the economy of the host country of the companies which decide to invest outside the country of origin, that are generally called transnational corporations, is represented by the FDI flows and by the stocks which “accumulate” from them. Therefore, it is important to see what explains the higher or lower measure of stocks as well as the course of FDI flows to certain areas/ countries, namely what has influenced their evolution.

Mobilization of financial resources to cover investment needs is a concern of all countries, developed or developing ones, of strengthened or emerging market economies. The *World Investment Report*, citing the experience of different countries, shows that "only countries that have managed to attract FDI, but also to mobilize their own resources have developed." Investment needs exceed, in almost all cases, the resources available at a given time. Therefore, there is even a competition between countries to attract FDI, as the size of FDI flows and stocks in a particular country or region depends not only on the funds available, otherwise limited, but the attractiveness of the country / region for investors, of what is called, with a generic term, investment climate.

According to the World Investment Report, analyzing the factors that determine a country's competitive position, and the decision of companies - foreign or domestic alike - to invest in an economy, the absorption capacity of that economy, as well as the investment results, depend on a number of factors and conditions, considered a country's competitiveness pillars by the Report on the competitiveness (UNCTAD, 2011).

The question on how to measure a country's attractiveness to investors was made. **Attractiveness factors** are found in a certain amount of competitiveness index, and they are, at the same time, ***factors that influence the decision to invest***. Nevertheless, highlighting the result of the attractiveness involves appealing to a distinct expression, showing the result of this activity in terms of FDI inflows. In this regard, UNCTAD reports on investments turn to the index entry of FDI, which has significance not in the absolute size but in the comparison between regions and countries. According to UNCTAD assessments for the period 2005-2007, the highest performance index FDI inflows, with 8656, is owned by Hong Kong, China, and the lowest negative value is owned by Surinam with -2535. Romania ranks 32 of 141 countries with a score of 2,566.

The Potential Index shows highest score for the U.S. with 0.618, and the lowest for Zimbabwe with 0.032; Romania ranks 69 of 141 countries with 0.194.

Competitiveness and attractiveness factors change over time. Because of technological changes, it diminishes the relative importance of "classic" or traditional factors, such as the access to certain natural resources or the low labor costs, and with trade liberalization and foreign investment regime, the national market size becomes less important, this being placed in an area widely liberalized.

Information technologies have become extremely important, because, by causing the development of new methods of organization and management, they facilitate the localization of production in different parts of the world. Furthermore, for more efficient production of complex goods, the product is decomposed into components and it is located the production of different parts in countries with suitable potential of acquisition of the production line for such components. Thus, components or operations of higher complexity are produced in countries with adequate technological capacity and, especially, with high skilled labor, while more elementary components or operations are transferred to less developed countries.

It can be said that technological progress and the liberalization of trade and investment not only give companies the opportunity to become transnational, but also more options in terms of geographic and investment focus to specific host countries.

In this context, in order to attract FDI, of great importance is the presence of clusters or cluster training conditions including FDI or even be shaped around them. The presence of FDI in different countries are moving to those areas / regions which may provide ***factors to increase the efficiency of investment***: specialized and skilled labor in the interest of investors, suppliers of materials and components they need, educational and research institutions, administrative institutions opened to facilitate the presence of investors in the area and even partnerships with them.

This type of investor that needs a network connection is radically different from the investor in earlier stages of industrial development, which was especially attracted by the presence of natural resources, of primary activities, following processing to be done in origin countries or in a country with potential for processing. Today, most FDI are technologically complex, which means that it can only be directed towards countries and regions able to offer the full range of conditions necessary for such investment absorption, for scattering its positive effects, respectively its efficiency.

Shatz and Venables say that currently, multinational companies, especially those in search of efficiency bound for the combined advantages: low cost, but productivity growth, technological skills, developed infrastructure and a stable political and institutional environment (Shatz , H., Venables, 2000).

2. ROMANIA - ATTRACTIVE PLACE FOR FOREIGN DIRECT INVESTMENT

In the twentieth century the foreign capital came in Romania mainly from the reinvestment of profits generated from the capitalization of Romanian economical resources. It mainly focused on the extraction and processing of oil, metallurgy, textile and wood industry. In 1938, in the oil industry, the main foreign capital was the English, Dutch, French, American and German. The expansion, after 1938, of the German capital in South - Eastern Europe, to the detriment of English and French, was also felt in Romania. On March 23, 1939, under pressure from Germany, it was signed "The economical Romania – German Treaty", whereby Romania was to become Germany's partner in agriculture. Such joint ventures have been set up for logging, bauxite and manganese.

In the interwar period although there were some discrepancies between the levels of development of various economic sectors, the absorption of foreign capital provided some increase in production of goods, which was also reflected in the socio-political environment.

After the Second World War, the former socialist countries were not the objective of FDI, until the end of 1970, but in a very small extent. Since that time, some openings began to appear, especially from Yugoslavia, followed by Romania. However, these foreign investments in the global FDI inflows did not exceed 0.1% until 1991.

In the poor economic conditions of the late 1980s, Romania's transition to a market economy was characterised by a largely unprepared business environment in order to face the challenges generated by the participation in international flows of goods and services.

The activity and organization of a system of attracting foreign direct investment in Romania after 1989 began, in fact, with the adoption, in March 1991, of the Foreign Investment Law and with the

Commencement of the Romanian Development Agency. In the six years that followed, foreign direct investment in our country grew slowly until 1998, when they increased almost 8 times.

Since that time, companies with foreign capital have increased the productive and commercial activity in the Romanian economy. After 2003, foreign investment grew at a rapid pace, currently the foreign-capital companies also being the largest in the national economy, although not all are subsidiaries of multinational companies.

Currently, the evolution of the turnover of the largest companies and groups in the Romanian economy suggest the dominant position of companies with foreign majority ownership. In 2010, the top ten biggest companies in the economy is fully occupied by them.

Table 1 - The biggest companies in Romanian economy

Nr. Crt.	*Company /group*	*Turnover in 2010 (mil. Euro)*	*Turnover in 2009 (mil. Euro)*	*Main shareholder*
1.	**OMV PETROM**	3.322	3.057,7	OMV (Australia)
2.	**AUTOMOBILE DACIA**	2.708	2.125	Renault (France)
3.	**ROMPETROLRAFINARIE**	1.690	1.495,5	The Rompetrol Group (Kazahstan)
4.	**ROMPETROL DOWNSTREAM**	1.628	1.400,7	Rompetrol (Kazahstan)
5.	**NOKIA**	1.500	1.027,8	Nokia (Finland)
6.	**PETROTEL - LUKOIL**	1.371	992,5	Lukoil (Russia)
7.	**METRO CASH & CARRY**	1.137	1.356,2	Metro (Germany)
8.	**CARREFOUR**	1.131	1.027,2	Carrefour (France)
9.	**ARCELOMITAL GALATI**	1.125	846,4	Mittal (India)
10.	**LUKOIL**	1.068	783,6	Lukoil (Russia)

Source*:* UNCTAD, *World Investment Report - Division on Investment and Enterprise*, 2010.

Since 2007, Romania has followed European trends of declining FDI inflows, except that the historical maximum was reached by the European Union in 2007, that of 830.8 billion dollars, and in Romania in 2008, 13.9 billion. The decrease by more than 65% for foreign direct investment in 2009, confirmed the existence of the economic gap between developed and transition countries in Europe. In 2010, Romania, as well as the whole Europe, was still under the impact of the economic crisis and the instability of financial markets, FDI flows to Romania reaching the lowest level in seven years, 3.57 billion respectively.

To encourage investment in our country, in 2010 the government granted state aid in amount of 214.5 million euros, which financed 10 investment projects worth 711.7 million euros. The projects addressed various fields, also leading to the creation of new jobs.

To evaluate the performance of countries in attracting FDI, United Nations Conference on Trade and Development (UNCTAD) calculates *a performance indicator (IPIi)* by reporting the percentage of each country's share of FDI from the whole investment in the share of its GDP on holds in global GDP.

The FDI Performance Index attracted by a country is calculated using the following mathematical formula:

$$IPIi_i = \frac{FDIi_i/FDIi_g}{GDP_i/GDP_g},$$

where:

$IPIi_i$ = FDI performance index attracted by the country;

$FDIi_i$ = FDI inflows of the country;

$FDIi_g$ = global FDI flows;

GDP_i = GDP of the country;

GDP_g = overall gross domestic product.

After applying this formula, a value greater than 1 indicates that the country receives more foreign investment than its economic level, a value below 1 means that the country attracts FDI below the level possible to assimilate, and a negative value demonstrates that in the period for which this index was analyzed, foreign investors stopped or reduced their investment. The index reveals the influence on FDI of factors such as economic and political stability, the presence of natural resources, infrastructure, technologies, the opportunity to participate in the privatization etc..

Table 2 - The index performance indicators for calculating FDI, 2008-2010 (millions USD)

Indicator / Period	***2008***	***2009***	***2010***
FDI flows in Romania	13910	4847	3573
GDP Romania	204339	161109	159338
Global FDI flows	1744101	1185030	1243671
Global GDP	61146661	58068608	63160663

Source: *UNCTAD*, 2011, http://unctadstat.unctad.org/TableViewer

Applying the mathematical formula given above for the indicators in table number 2, the following values of Romania attracted FDI performance index result:

Table 3 - Romania FDI Performance Index, 2008-2010

Romania	***2008***	***2009***	***2010***
IPIi	2.424	1.464	1.160

According to this indicator, in 2010, Romania ranks 73 of 141 countries analyzed, on a lower rank compared with 2009 (No. 63) and 2008 (No. 42) (Table 4). From Table 4, we observe that our country ranked a higher position according to this index, in 2005 - the 28th and 24th, in 2006. The score calculated for the period 2008-2010 is declining from 2.42 in 2008, 1.47 in 2009, to 1.16 in 2010 (Table 3), which means that the performance of attracting FDI in our country has increased in 2008, but has decreased since 2009, as the manifestation of the global economic crisis in our country. These values, greater than 1, indicate that Romania receives more FDI than its economic level.

Table 4 - Performance of FDI inflows in Romania, 1990-2010

Country	**1990**	**1995**	**2000**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**
Bulgaria	103	92	22	11	7	4	5	27	42
Czech Republic	-	20	17	15	70	53	87	97	50
Estonia	-	21	27	3	19	16	36	14	23
Hungary	33	4	33	25	44	97	60	95	81
Latvia	-	31	41	50	27	36	73	132	100
Lithuania	-	75	64	54	45	64	66	131	90
Poland	94	42	38	65	49	60	90	60	75
Romania	-	73	75	28	24	57	42	63	73
Slovakia	-	2	13	41	26	69	58	138	124
Slovenia	-	88	116	106	116	92	76	141	88

Source: after UNCTAD, *World Investment Report - Division on Investment and Enterprise*, 2010.

Compared to neighboring countries, Romania's performance in attracting FDI is higher than in most countries in the region. Thus, Poland is ranked 75, followed by Hungary (No.81), Slovenia (No.88), Lithuania (No.90), Latvia (No.100) and Slovakia (No.124). Estonia (No. 23), Bulgaria (42) and Czech Republic (No. 50) are however economically more attractive for investors (Table 4).

Another indicator calculated by UNCTAD refers to *potential FDI inflows*. According to it there can be discrepancies between the potential of FDI inflows and their performance itself. The UNCTAD FDI Potential Index ranks countries according to their potential to attract FDI. This index is based on structural factors that tend to change very slowly. As a result, the index value is relatively stable over time. The index of the potential measures the effects which bring about factors able to affect the attractiveness of an economy in terms of foreign investors, being an average (normalized so that the result is between 0, for countries with low scores and one for countries with high scores) of 12 economic and political variables.

Romania's place, during the entire period 1995 - 2009 (Table 5), shows that the potential of FDI inflows in Romania is relatively low, while demonstrating economic and political instability of the Romanian economy. Compared to neighbouring countries, Romania has a low potential for attracting FDI, being on a lower place than the Czech Republic (36), Poland (43), Slovakia (45) and Hungary (46) and Bulgaria, with 62.

Table 5 - Index of the potential FDI inflows

Country	1990	1995	2000	2005	2006	2007	2008	2009	2010
Bulgaria	-	41	64	58	56	55	62	62	-
Czech Republic	-	37	39	37	39	35	36	36	-
Hungary	48	56	41	42	42	42	46	46	-
Poland	55	57	43	44	44	43	43	43	-
Romania	-	89	93	71	69	65	64	64	-
Slovakia	-	39	45	51	51	46	45	45	-

Source: *UNCTAD 2012 World Investment Report*

CONCLUSIONS

Determinants of FDI in an economy are economic, political and social, with a greater or lesser influence on the volume of FDI in the economy.

Such research demonstrates that Romania's economic growth has not automatically attracted foreign direct investment. The main factors of choosing Romania as FDI is relatively low cost of labor, the high level of skills, market size, the legal environment, non-discriminatory and attractive for foreign investment, the low cost of raw materials and utilities and the open attitude of local and central authorities towards the foreign investors.

On the other hand, there is a number of factors that have limited the growth of FDI in Romania. The weaknesses of the Romanian economy, as FDI platform, which have increased with the onset of the global financial crisis, are due to the small number of experts in finances. Moreover, other factors are to be considered: the difficulties encountered by the companies to adapt to market changes, the financial institutions' lack of transparency, slump stocks, but also the little direct investment made abroad, weak earnings from tourism, real GDP growth and the fact that public contracts are not open to all bidders.

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