Evolution of FDI Flows in the Integration Context

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Abstract. *The following paper tries to emphasize the role played by the European integration process in Romania's FDI flows. We analyze the new factors which may determine the FDI flows and the importance of FDI inflows in the balance of payment. The information is supplied by ARIS – the Romanian Agency for Foreign direct investments and UNCTAD – World Investment Report 2006.*

Key words: foreign direct investment (FDI); area integration.

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1. Integration process – costs and advantages

The collapse of the communist regime in Central and Eastern Europe, shortly followed by the first steps of the integration process within the European Union and NATO have been, to a great extent, influenced by the geo-political background. The setting of a connection between Romania's economy and the European Union complies with the general flow, with the area orientation and direction, and last but not least, with economic and politic interests.

The European Union supports the transition process that has been developing in the Central and Eastern Europe countries, and monitors the fulfillment, by the candidate countries, of well defined criteria set on the occasion of the European Council from Copenhagen held back in 1993.

The European Union integration process implies, for Romania, not only a series of advantages, but also costs at the economic and political level.

As concerns the political aspects, the integration direct impact shall be visible at the legislative level as a sequence of having adopted the community "acquis", modifications of the Constitution and issues related to the representation and participation in the European decision-making process. However, the indirect impact shall consist in the re-orientation of the foreign affairs policy, mainly of the commercial policy, and last but not least, in the appearance of new government policies that are compatible with the European requests. All the same, the integration process shall confer Romania new perspectives at the international negotiation level with reference to national interest problems that are being debated both at the European and the worldwide level, too.

As far as the economy is concerned, it will be the investment flows, first and foremost, that shall have a direct impact and that shall register an unprecedented boom. The basis for this trend is mainly the increase of Romania's credibility at the international level further to having adhered to NATO and to the European Union.

Secondly, the foreign trade liberalization and the enforcement of community regulations with reference to the competition domain shall have visible consequences on the business environment and background. Let us not forget, however, that any such economic launching and "opening" might imply risks, as well, although both the classical and the neo-classical theories assert that a nation's welfare shall increase further to a no boundary trade policy, basically due to the statistic and dynamic effects of the economic development.

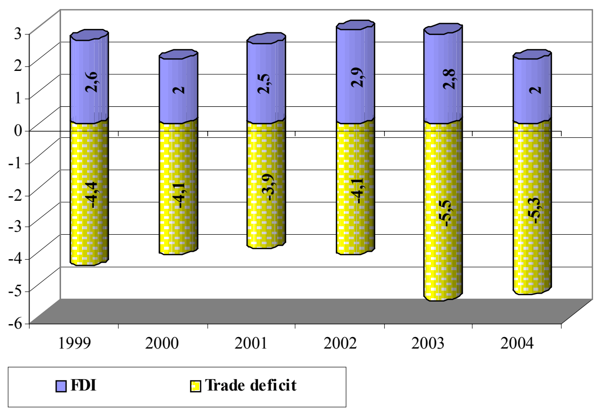
Thirdly, Romania's economy shall benefit by access to European financing, so far materialized under the form of pre-adhering funds (PHARE, ISPA, SAPARD), financing that, effective the 1-st of January 2007, has acquired the form of structural funds. The agriculture domain shall also be supported and helped by implementing Community Agriculture Policy instruments.

As a conclusion, it can be freely asserted that any isolation scenario would cost Romania more than the so-called adhering approach.

The study achieved by the European Institute from Romania supports and is in favor, once again, of the necessity to adhere, mainly if the idea is approached from the point of view of the relationship between the foreign direct investments, on the one side, and the balance of payments, on the other side.

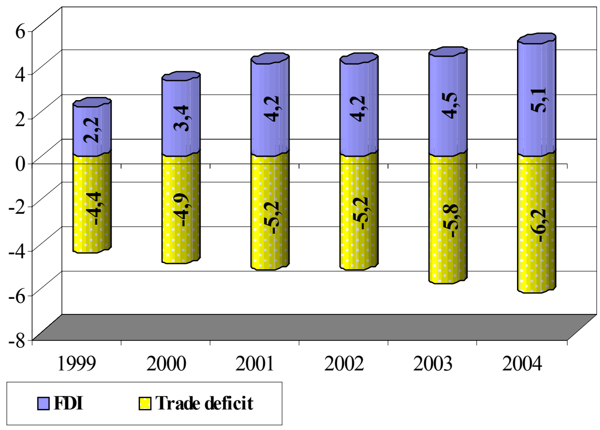
Foreign direct investments can play an extremely important part in the attempt to equilibrate the balance of payments by counteracting the trade balance deficit. The below charts introduce the two possible situations. The charts illustrate the isolation scenario case where the trade deficit financial degree further to foreign investments is more reduced than compared to the integrationist situation. Although as far as the integrationist scenario is concerned, a higher trade deficit shall be noticed, this one can be "covered" to a higher degree by perfectly sustainable means offered by the foreign direct investments and by the funds transferred from the European Union, whereas the net financing necessary fund, to be "covered" by loans, is much smaller in case of the integrationist scenario.

At a level of – 6,2% for 2004 for the integrationist scenario, the current account deficit is still within sustainable limits. However, unlike the consolidated general budget deficit, the trade balance deficit came, at the end of 2005, near the upper limit of what can usually be considered as a sustainable level.



Source: European Institute from Romania.

Figure 1. *Isolation scenario*



Source: European Institute from Romania.

Figure 2. *Integrationist scenario*

As a conclusion, we can openly assert that, in case of Romania, the only viable solution that would grant it a durable economic development based on substantial in-comings from foreign direct investments would be the European Union integration. The integration would certainly assure all the premises that are necessary to attract foreign investment to Romania by adopting the community "acquis".

Let us imagine a scenario in which Romania's adhering process had been postponed; rest assured that Romania would have registered a dramatic decrease of any direct foreign investment in-coming.

1.1. Adhering process impact on investment flows

One of the implications of the process to adhere to the European Union is represented by the increase of the foreign direct investments as they represent a main problem around which gravitates the entire process to quantify the costs and benefits and advantages while taking into account the present need of capital. Nevertheless, there should be underlined the enormous importance of foreign direct investments on sustaining and backing the technology international transfer by means of bringing in the necessary financing funds.

It is worth mentioning here that the investment flows coming from the European Union are presently 5 times higher they would have been if Romania had decided to remain outside the European Union. In case of the isolation scenario, the foreign direct investments would have registered much lower increase rates, if not even negative rates.

Several studies (Bevan et al., 2006) indicate that there has been a correlation between the notification related to the European Union expansion and the evolution of the direct foreign investment in-flow in the Central and East European countries. The announcement made by the Council from Essen in 1994 was followed by a significant increase of direct foreign investment in-flows in Hungary, the Czech Republic and Poland (Table 1). More than that, the decision reached by the European Union in 1997, namely to initiate negotiations with five of candidate countries, also led to increasing the direct foreign investment in-flows into these countries, thus stimulating and encouraging the economic development and the re-structuring process.

Table 1

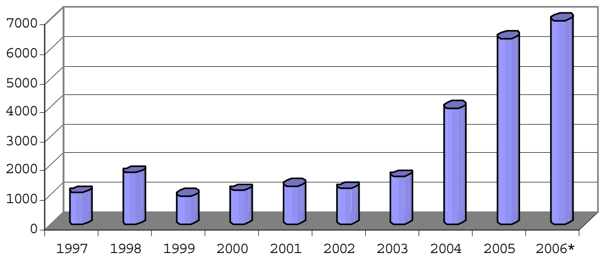
	ISD in-flows (millions of USD)			ISD out-comings (millions of USD)		
	Hungary	The Czech Republic	Poland	Hungary	The Czech Republic	Poland
1990	2137	2101	4589	1644	206	305
2000	4654	4974	12873	1122	1014	794
2005	6699	10991	7724	1346	856	1455
Total	13490	18066	25186	4112	2076	2554

Source: World Investment Report 2006 – UNCTAD.

Experience has shown that, generally speaking, the adoption of the European norms has had benefic consequences on direct foreign investment in-flows, but, however, there existed negative situations, as well. Domains such as the market of financial bonds and the non-banking financial services have been proved not to have a positive impact, and, in case of the competition-related regulations, the impact has actually been negative.

Romania and Bulgaria are the main two destinations for foreign direct investments towards the South-East Europe in view of their integration into the European Union[1]. The integration shall generate more and more favorable conditions for foreign investors. At the level of 2005, almost half of the direct foreign investment in-flows made in the area were directed towards Romania.

Last year, the foreign investment flow for this area exceeded 8.6 billion Euros (figure 3), which is a new record as this represents around 5% of the area's Gross National Product. For the past five years, the investment flows marked a remarkable dynamics as the increase was almost 4 times and the total direct foreign investment volume for the area amounted almost 41 billion Euros. Were we to judge against the direct investment volume per inhabitant (in 2004 that was only 800 Euros/ inhabitant), we could assert that the attracted investment volume continues to be rather low for the South-East of Europe.



Source: World Investment Report 2007 – UNCTAD.

Figure 3. *FDI evolution in Romania (millions USD)*

At the same time, the economic increase of 6.5% registered, in average, by the candidate countries proves to be superior to the increase registered by the new member countries.

The temporary information for the first three months of 2006 as it is offered by World Investment Report – 2006, indicates a total flow of the foreign direct investments of 6.3 billion Euros.

The direct foreign investment flows attracted by Romania can be placed at a satisfactory level, under the conditions in which the government party replacements have determined the foreign investors to act cautiously, especially during the first month of this year so as to allow them to analyze the macro-economic policy modifications.

At the same time, the foreign partners' abeyant approach has been obvious even previous to signing Romania's Adhering Treaty to the European Union, situation that has been registered with other countries that adhered to the European Union in 2004.

The Romanian Agency for Foreign Investments centralized the statistic data sent by the Area Development Agencies with reference to registering the significant impact investments on the economy, investments that benefit by the stipulations of Law No. 332/2001. During the

January – September 2006 period, there have been registered 616 projects, the value of the assumed investment amounting to 6.106 billion dollars, whereas the foreign contribution amounts to 4.290 billion dollars that means 70.25% of the general total. Till the month of August, there have been finalized 313 projects whose value amounts to 2.529 billion dollars.

According to the studies made by the Romanian Agency for Foreign Investments, the year 2006 was going to atract a direct foreign investment volume of more than 7.5 billion Euros. However, this information depends on a series of factors that are related to the risk factors of the investments to be made in Romania, factors that are presently at a re-evaluation stage such as the inflation rate and the economic development indices, and also the legislation stability. All these elements entail the long-term business environment predictability depending on the previously mentioned factors; thus the new economic and politic context has generated a series of other new factors that would be able to greatly influence the foreign investment in-flows from the area:

- dissipation of foreign direct investments by enlarging the European Union boundaries;
- credibility conferred by Romania's adhering to the European Union;
- under the integration conditions, the internal market dimensions do no longer represent an advantage/stimulating factor, which transfers the competition for ISD to the level of the work force costs and qualification, as well as to the level of corruption and fiscality.

The direct foreign investment in-flows shall register higher increase rates during 2007 – 2012. As a matter of fact, during the past years, the powerful economic development has been doubled by an unprecedented investment flow.

For the future, further to the integration, the direct foreign investment in-flows oriented towards the private domain might decrease, which shall trigger massive imports towards the services domain based on the evolution registered on the labor market. The problems that have appeared to the balance of payment domain and to the trade balance domain shall be solved step by step further to the integration.

The cut-down of taxes, the stock account liberalization and the inflation target give birth to new monetary and fiscal problems. As for the present moment, these challenges are not supported by an adequate set of macro-economic policies. This triggers the increase of internal and external deficits, a state domain that dramatically lacks funds for major reforms in the social sector and for investments in infrastructure, and can generate a partial loss of the competition gains achieved along the past years.

To increase competition and to attract a higher volume of foreign direct investments which have become necessary to cover the current account increasing deficit, the authorities shall have to narrow down the set of economic policies, to make them credible and coherent, and, at the same time, to continue the structural reforms. But most of all, a main position within the agenda is taken by the reform related to the labor force market, to aligning the internal prices to the international ones, and last but not least, to the efforts to increase transparency and responsibility in the fight against corruption.

For the past few years, Romania has managed to attract significant amounts of funds and higher and higher foreign direct investments further to the political decision to limit the state's part in the economical domain and also further to registering relatively low costs with the labor force, so far.

Romania must strengthen the capacity to attract foreign direct investments for new projects which depend on a good background for investments and on the assurance of a quality and competitive labor force, within the restricted domain of the European Union's marke regulations.

Note

(1) According to "World Investment Report 2006" - UNCTAD

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