Foreign Direct Investment and Regional Development in Romania

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Abstract: *The regional integration of the Romanian economy implies the continuation of modernizing existent structures, expanding the new entrepreneurial culture and foster the individual competences for corresponding to the European model. Foreign direct investments represent the link between financial and productive systems, integrating them at a regional and global level. Beside the imported capital flows, they have a direct impact upon the management of the productive entities, assure a transfer of modern technologies, increase the level of occupation and the household available income, modifying the consumers culture.*

The regional development policy must ensure the reduction of disparities between the different levels of development of the Romanian regions through encouraging foreign direct investment capable of completing the little dimension of the local capital. Taking into consideration the movement of disparities to East and the fact that the increase of economical development disparity after the last two European Union enlargements did not involve a higher level of allocated funds, foreign direct investments remain an alternative for the disparity elimination and accelerating the restructuring marked by the globalization

Keywords: regional development**,** socio-economical disparities, foreign direct investments

1. Regional disparities in a global context

Regional integration process has known an important development along with the worldwide economy globalization process. These two processes bring transformations of the local economical and social systems that are slowly downshifting and eliminates the stagnation that triggers, maintains and emphasizes under-development. Regionalization has created some areas of free exchange, customs and economical and monetary unions (AELS, NAFTA, MERCOSUR, ASEAN, CEFTA, CSI, UE) by which the member states wish to obtain benefits as a result of investments and commercial flows liberalization along with economical development.

European economical and quasi-monetary integration has emphasized competence on a broader marker, having great influence upon the position of companies on the market, favoring developed regions and emphasizing existing disparities. European countries have become aware that eliminating the disparities between different production levels, between internal gross product per inhabitant, the degree of work force employment in the member states, between and in the regions cannot be eliminated by market mechanisms. European regional policy is trying to decrease disparities generated by differentiated economical development due to natural causes, technological differences, different capitalization during the time, because these influence competitive and economical growth in the European Union.

The gap that Romania has to recover is significant, although at the level of real convergence it has registered a growth of the gross internal product (GIP)/inhabitant, calculated for the purchase force standard. This is still under the UE-15 respectively UE-25 average, although it has increased at the end of 2004 by 5.8% and 5.9% compared to the year 2000 (Appendix 1). Calculated by the purchase force standard, the GIP/inhabitant has increased from EUR 1795.3 in 2000 to EUR 2718.3 in 2004. It is estimated that by the year 2013 it reaches 41% from the European Union average.

Compared to the rest of the member states, in Romania inter-regional discrepancies in relative terms have reached levels that can be compared to the Czech Republic, Slovakia, Belgium and France, but in absolute terms they are relatively small compared to the European Union. On the grounds of the GIP continuous growth, by 5,3% in the last seven years (Appendix 2) an gross fixed capital annual average raise from 8.6% in the timeframe 2004-2005 to 12% in 2006 has been produced, to capital goods imports for modernization and re-engineering of production facilities, to which the new buildings are added (Appendix 3).

Estimates related to maintaining the growth of fixed capital formation by an annual average rate of 10.8% (Appendix 3) in the timeframe 2007-2013 is an optimistic one, based on the replenish of financial and human capital by external financing products, so that the GIP investments increases from 23.6% in 2006 to 30.8% in 2013.

Within the competition growth, generated by the regional integration and by the globalization process effects, it is estimated that the GIP growth shall be outrun by the growth rates in constructions and services (Appendix 4). A higher rhythm is estimated for goods and services exports, as a result of current markets consolidation and development. However, a small degree of EU funds absorption, the reduction of EU economical growth and the international prices explosion, would trigger the economical activities tightening, exports reduction, unemployment raise and current account deficit increase, as well as the economical activity reduction by 1.5% every year.

Under the circumstances that the strategic inter-connections and alliances between firms, regions and states are multiplied, emphasizing market independence, Romania must coordinate and concentrate national financing instruments, with community ones, while attracting direct foreign investments. The importance of direct foreign investments is raised if the capital flows, technologies, innovations, trades flows, decisions and activities performed in some part of the world have effects over some distant communities.

2. Direct foreign investments dynamics and origin

Statistical data show that in the transition period, the syncopated dynamics of economical macro-stabilization, of the privatization process, of structural adjustment within institutional, legal and economical level have affected the interest that foreign capital has shown for direct investments in Romania. At the beginning, the numerical explosion of newly incorporated foreign participation companies has been stimulated by tax exemptions, awarded for various timeframes, according to the activity domain and to a high level of fiscal evasion. Quantity implosion and foreign capital repatriation upon these exemptions expiry date, has taken place in the context in which international economical environment had overcome the crisis, and on internal level, along with the elimination of tax exemption for foreign investments discrepancies between the monetary policy and structural adjustments were maintained. These have not triggered an inflow of new technologies and management methods, since they had as main objective import products trade and as effect the emphasizing of payments commercial balance.

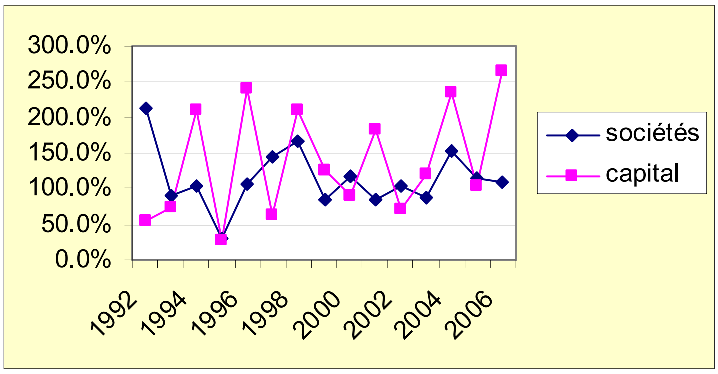

Figure 1 – Dinamics of companies with foreign participation and the value of apported capital in the period 1996-2006

The decision of privatization process acceleration has triggered foreign investors' interest increase. Foreign capital has oriented towards existing economical entities within the privatization process, along with creating, instability and legal confusions regarding direct investments, inflation level, slow economical macro-stabilization, transport infrastructure deterioration, bureaucracy and corruption. After 17 years of transitions, the number of companies with foreign participation has increased by 2399.4% in 2006 compared to 1991. Although paid capital calculated in euro has had a slower rhythm, it still has been at the end of the last year 1880.1% higher than in 1991. Their impact upon existing structures transformation, although undeniable, has been slower compared to Romanian economy needs.

At the end of 2006 it is noticed that the majority of direct foreign investments come from resident investors in Europe, followed by South and North America. However the percentage of companies owned by investors from Asia outrun the American investors. In the meantime dominant European capital has concentrated over a reduced number of economical entities, Asian capital being dispersed in a high number of small entities in the area of retail trade (Appendix 5). Main activity sector that benefited from capital inflow was industry, followed by services sector, and upon greater distance by trade and transports.

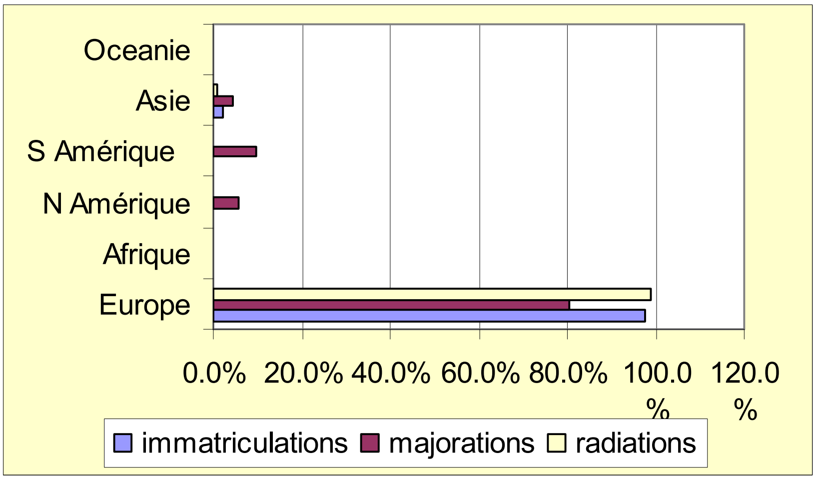

Figure 2 – Percentage of foreign capita taking in consideration the residency of the investors, on various continents

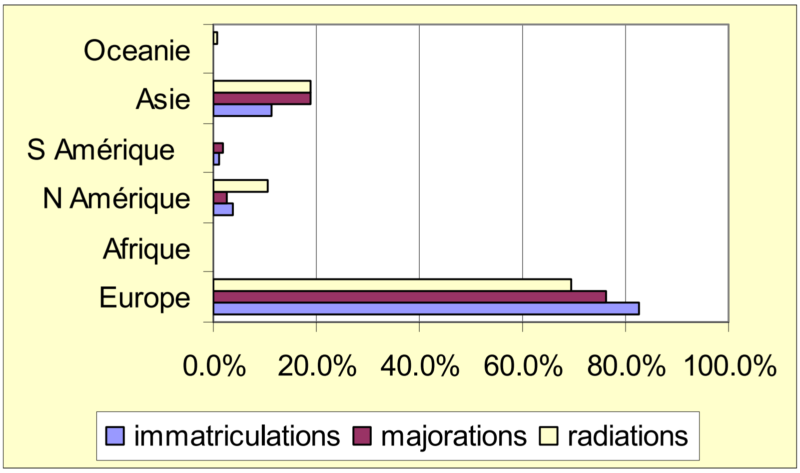

Figure 3– Percentage of companies taking in consideration the residency of the investors, on various continents

However, we noticed a greater instability of foreign capital, illustrated by great percentage of dissolute companies and capital repatriation. This situation is also confirmed by evolutions of capital coming from European investors, from various economical groups.

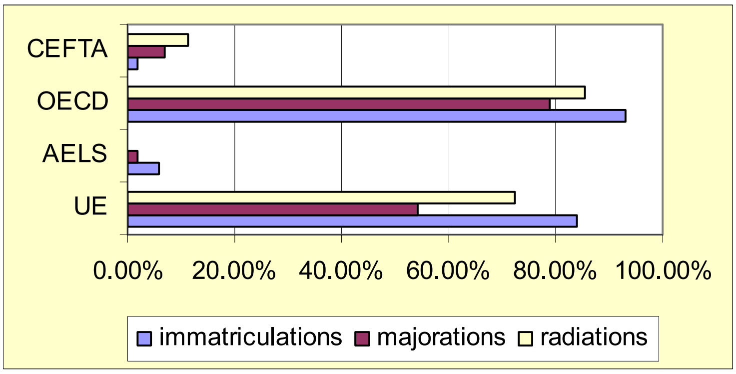

Figure 4 – Percentage of foreign capital taking in consideration the residency of investors, from various economical groups

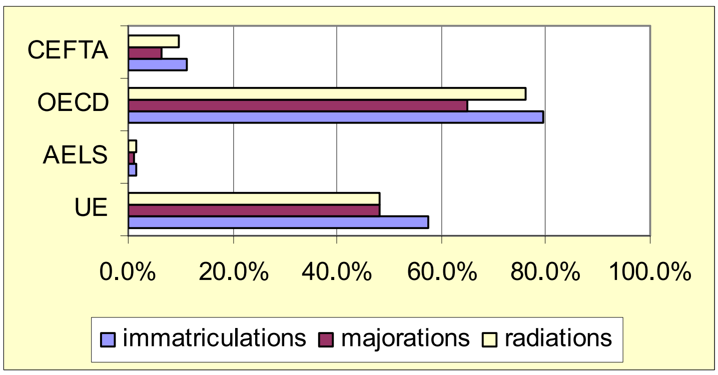

Figure 5 – Percentage of companies depending on the home country of investors, from various economical groups

High percentage of direct investments by resident investors in OECD and European Union member states is related to entering on the market of some large industrial and financial groups, either on industry, energy, telecommunication of banking sectors privatization, or on financial services expansion and delocalization of some economical entities in Romania. However Romanian economy is actively integrated in the European economical environment, if we take into consideration direct foreign investments origin (Appendix 5). Under the circumstances of direct investments dominance from member states, the Institute of International Finance estimates that in the year 2007 their value shall reach 6.6 billions of Euro, respectively 4.7% from the GIP, according to the evaluations of Standard & Poor's.

3. Foreign investments destination and inter-regional disparities

During the last months before joining the EU, an extremely disparate distribution of foreign investments if maintained in the 8 development regions. Under the circumstances that the number of companies with foreign capital participation incorporated and the foreign capital value paid by the investors, the Bucharest-Ilfov region detaches itself greatly from the other regions, the foreign capital value of and of dissolute companies outruns the paid in capital and incorporated companies, although there is an accentuated tendency of business consolidation by capital increase. At the same time, investors' interest towards western regions is observed, under the circumstances that the foreign capital stability invested in the Western region is net superior to that in the North-West region. The structural analysis shows that, although foreign capital oriented to the other regions is more reduced, investors have performed capital increases higher than the paid in capital. Capital stability, interest for business development by consolidation represent factors that, if become permanent, shall contribute to the economical increase of regions that remained behind.

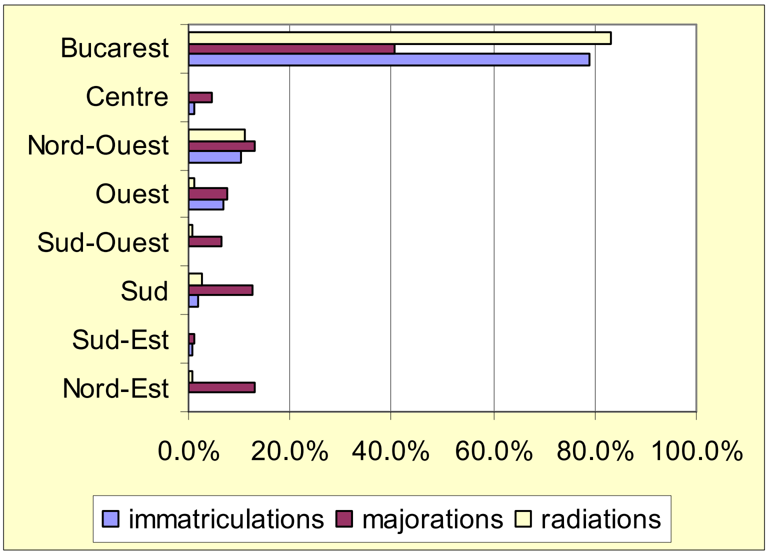

Figure 6 – The proportion of foreign investments on various regions NUTS II (December 2006)

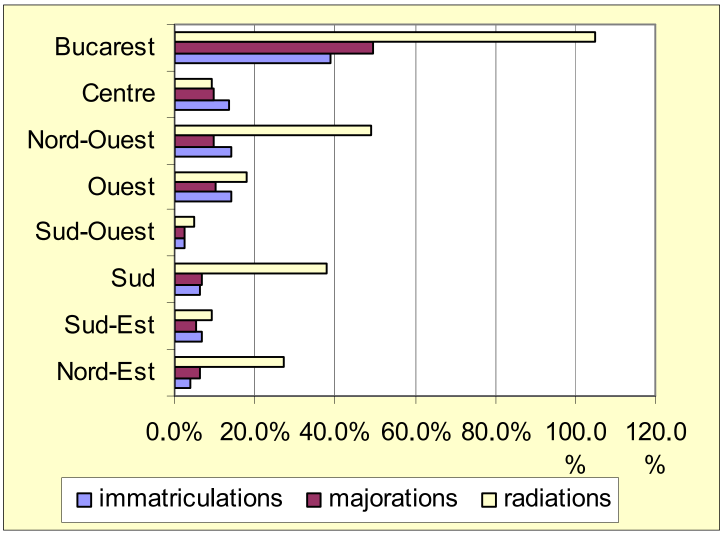

Figure 7 – The proportion of companies with foreign participation on various regions NUTS II (December 2006)

Although Romania has begun the transition process, with a lower level of regional disparities compared to other member or candidate states, last statistical data show that the disparities have rapidly increased between the Bucharest-Ilfov and the other regions.

Table 1

Indicators of regional development in Romania (national average=100)

Region	GDP/inhabitant		Unemployment rate		FDI/inhabitant		SME/ Inhabitant		Rural Population	
	1998	2003	1998	2003	1998	2003	1998	2004	1998	2004
North-East	79,8	72,3	133,6	123,8	15,3	23,7	71,3	77,1	123,9	125
South-East	100,1	85,7	112,5	109,5	42,7	87,2	101,4	111	94,7	98,7
South	85,8	81,2	97,1	117,5	65,5	66,6	77,0	83,1	129,0	130
South-West	90,0	84,7	104,8	119	11,9	28,4	85,9	86,1	120,8	117
West	100,9	112,9	101,9	92,06	99,1	59,2	91,2	124,4	83,8	80,4
North-West	95,5	96,6	84,6	66,7	41,9	53,3	106,5	124,8	104,9	104,7
Centre	105,9	107,2	98,1	123,8	87,7	50,7	101,1	125,2	87,1	88,7
Bucharest-Ilfov	162,2	194,9	47,1	44,4	598,3	430,8	194,1	257,8	24,8	20,8

Source: The Statistical Annual of Romania

Center-suburbs disparity is generated by the same process of concentrating the economical activities in the region that includes the capital city (this can also be found in Austria, Belgium, the Czech Republic, France, Great Britain, Portugal and Sweden), along with their diminishing in the border areas towards former communist countries (this situation is identified in Germany and Austria). It is the case of region at the border with Moldavia, in the south, along the Danube and in the northern, at the border with Ukraine.

At the regions level, there are disparities determined by heterogeneous development areas, due to small, mono-industrial towns, strongly affected by the restructuring, reduced economical diversification of some big cities and due to the incapacity of some urban centers of becoming development vectors for adjacent areas. The under-developed regions are those dependant on agriculture, with great rural population where trans-border transport, is little developed, comparing to those in the opposed corner, whose dependence on the primary sector is reduced.

For direct foreign investments attraction the government has taken measures to created a favorable legal and institutional environment for the business development and for attracting foreign capital in priority areas. Among the measures taken by the state to encourage direct foreign investments, e have: the creation of the Romanian Agency for Foreign Investments – ARIS, responsible for enforcing Government policy for promoting and attracting direct foreign investments. This coordinates the promotion strategies for direct foreign investments, the development of action programs for attracting foreign capital in the economy and monitors the fulfillment of the legal provisions and initiates projects of legal acts for improving the legislation, which are submitted to the Government for the approval. The introduction of the single taxation quota, of 16%, has contributed to the placing Romania among the most attractive destinations for investments in the region.

All 8 NUTS II regions of Romania are eligible within "Convergence" and "Regional Competition and Work Force Employment" objective. In the year 2007, the co-financing of investment programs for development from national and local public sources shall be of 549,04 Millions Euro, covering 14.25% from the total public expense of the Operation Program for Regional Development. The co-financing from national private sources is estimated at approximately 28,90 Millions Euro (0.75%), and that of the European Fund for Regional Development shall represent 85% from the total of eligible expenses. Foreign capital inflows estimated at 6.6 Billions Euro, along with contracting extern credits from BEI, BERD and BM may accelerate the elimination of competition differences and some of the inter-regional disparities.

An extremely important role in eliminating intra and inter-regional disparities is the help Romania shall receive from the European Community. For the operational programs that benefit from European co-financing, for the timeframe 2007-2013, Romania shall receive 17,264 Millions Euro from Structural and Cohesion Funds of the European Union. From this amount, 3,275 Millions Euro shall be allocated to the Regional Operational Program destined for the FEDR development, that shall support the financing from national public funds of 549,04 Millions of Euro and national private funds of 28,90 Millions of Euro.

4. Conclusions

Promoting a policy of cheap labor force has determined the urban-rural migration due to maintenances small salaries and of an under-developed agriculture, along with migration towards other countries. Moreover, population natural growth has been affected by low level of life quality. As a result, investors begin having problems in recruiting qualified work force. Moreover, reduced level of consumption in the other institutional economy sectors influence the income from the entities in other sectors of economy. Therefore, measures for income raise, along with migration stop are needed, since foreign capital attraction is triggered by market dimension and available work force qualifications.

Creation of some modern transport, telecommunications, electricity and gas infrastructures in touristic areas and adjacent to great urban centers, that would ensure delocalization of economic activities in these areas, would allow a better income dispersion and partial absorption of involuntary unemployment.

Along with attracting foreign investments towards sectors with a greater added value from information and communications technology, electronics and electrotechnics, services, energetic industry the promotion of an investment climate is needed in international business environments. Along with promoting an entrepreneurial culture, managers training n market strategies and business risks management is also needed.

Annex 1

Dinamics of GDP and the European Union average GDP

	2000	2004	Growing
EU-15	23%	28,8%	5,8%
EU-25	25,2%	31,1%	5,9%

Source: National Institute of Statistics and National Committee of Prognosis

Annex 2

Dinamics of GDP in the period 2000-2013

PROCENTUAL MODIFICATION (%) IN COMPARISON WITH THE PREVIOUS YEAR							ESTIMATIONS
2000	2001	2002	2003	2004	2005	2006*	The average rate 2007-2013 (%)
2,1%	5,7%	5,1%	5,2%	8,4%	4,1%	6,7%	5,6%

Source: National Institute of Statistics and National Committee of Prognosis

Annex 3

GDP on different fields of activity
- procentual modifications -

	2006	Average rate 2007-2013 (%)
Industry	6,4	5,1
Agriculture	1,5	2,7
Constructions	13,0	10,2
Services	6,5	5,7
GDP	**6,7**	**5,6**

Source: National Committee of Prognosis

Annex 4

The source and destination of foreign direct investments (December 2006)

THE RESIDENCE COUNTRY OF INVESTORS	% APPORTED CAPITAL	% COMPANIES WITH FOREIGN PARTICIPATION
Holland	21,06%	2,04%
Austria	12,94%	3,18%
France	10,27%	3,56%
Germany	10,24%	10,77%
Italy	5,56%	16,31%
USA	4,72%	3,73%
Great Britain	4,43%	2,05%
Cipru	3,96%	1,83%
Greece	3,61%	2,73%
Other countries: 40	23,21%	53,8%
Total	100%	100%
From which: Capital structure on fields of activity and companies:		
-industry	50,6%	17,7%
-constructions	1,6%	5,7%
-transports	6,4%	3,4%
-wholesale commerce	6,7%	26,7%
-en detail commerce	6,3%	12,2%
-turism	1,5%	5,6%
-agriculture	0,9%	4,5%
-proffesional services	26%	24,2%