

THE IMPACT OF FOREIGN DIRECT INVESTMENT ON THE FIXED CAPITAL ACCUMULATION IN THE ROMANIAN ECONOMY

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Key words: foreign direct investment, fixed capital, capital accumulation, tangible fixed assets

Abstract: The foreign direct investment (FDI) has become more and more important over the last couple of decades. Known to be one of the latest factors to stimulate the economic growth, affecting directly the social and regional development, the foreign direct investment is now also one of Romania's priorities. The FDI is more than just a mechanism to help integrate a country into the world's economics; it is the liaison between the productive systems of different nations. This article will emphasize how important is the FDI to the sustainable development of the Romanian economy, by watching closely its impact on accumulation of fixed capital between 2003 and 2006. Therefore, we will see the FDI growth over the last few years. Romania has significantly improved in 2004, when the FDI went up to more than 5 bill euro. Nevertheless, the record value of FDI has been registered in 2006, reaching almost 9.1 bill euro. I believe that the FDI was quite relevant in developing the Romanian fixed capital.

The foreign direct investment can be considered the main factor in the capital's globalization and, through capital, of the entire world economy (Joong-Wan Co, 2003). As the foreign direct investment gained such importance in developing the economical growth, it made quite a few countries, especially those developing countries, try harder to obtain the FDI. Therefore, they have amended the macro economical politics and eliminated any back drawing legislation. Statistics show that FDI has become even more important than foreign trade. The foreign direct investment is more than just a mechanism to help integrate a country into the world's economy; it is the liaison between the productive systems of different nations. Any strategy to bring the FDI has to consider every country's or region's specifics (Blomström Magnus, Kokko Ari, 1997).

The FDI played an important role in enterprise restructuring of transition countries in Central and Eastern Europe. These countries' governments also provide incentives for FDI. Justifications for these special incentives are the possible positive effects, which foreign direct investment has on the productivity and economic growth, in the host countries. Studies have shown that the ability of a country to take advantages of FDI externalities can be limited by local conditions, such as development of the local financial markets and level of labor qualifications.

Known to be one of the latest factors to stimulate an economic growth, affecting directly the social and regional development, the FDI is now also one of Romania's priorities.

In Romania, the transition period has imposed numerous capital changes. The capital's change from a state property to the private businesses has carried over consequences over the economic efficiency. The need for new technology and restructure in all of the Romanian companies has highlighted the importance of building

up fixed capital. At the same time, the slow process of state companies becoming private businesses has also slowed down the accumulation of fixed capital and ultimately the revival of the economical growth.

Putting a stop to the downfall, specific to any economy in transition, and the revival of the economical growth could only happen through a vigorous investment effort, used as a dynamic accelerator in bringing up technology, products and economy as a whole. It's a proven fact that investments are the main source of economical and social development of any country, that they ensure the qualitative and quantitative growth of the fixed capital, the expansion of the technical and economical capacity of the existing capital, and let's not forget the increase of work places. As well as other countries from Central and Eastern Europe, Romania has tried in the 90's different solutions to stimulate the accumulation of our own capital, through internal taxation policy. Most of these trials did not reach their purpose and they were soon to be abandoned. It was proven, that only encouraging the internal capital accumulation did not help the transition issues. The non-existing funds in the Romanian economy and high interests imposed by the banks brought the delay of the economic growth revival. There for, the FDI had become a real necessity, imposed also by the technological level of existing fixed capital in Romania.

Before lining up for EU, the FDI regime underwent essential changes to stimulate foreign investments. Fundamental particular principles, adopted in EU, have been put across in the Romanian legislation: freedom of investment choices, the free access to the market in all economical fields, the equal rights given to foreign (residents as well as non-residents) and Romanian investors, the opportunity given to the foreign investors to take back to their countries the benefits of their investments, after paying off the due taxes, the freedom of the foreign exchange market, the investment's protection through guarantees of property rights.

A major change was brought into the law system, broadening the rights of foreign investors to become property owners as well as being able to own natural resources. Embracing a new Constitution led to the initiation of a legal frame, which allows certain properties to be in the ownership of Romanian and foreign investors by preliminarily transiting the state's public domain to the state's private domain and ultimately this transit allows the transit of these properties into the ownership of private investors (Bran Paul, 2002). Before 2003 investments in state's public domain could only be done through concessions. There were also changes in owning the natural gas piping system, water system or drainage which were exclusively being used for productive units.

The availability of property rights increases also the environmental responsibility. For example, if an investor needs a water source and this can be easily found close to the factory, the investor can buy property rights over a water segment. The investor uses this resource for production, treats it adequately on its way out of the productive process and releases it. There for, as the investor owns the water segment, the accountability towards the water source has increased as opposed to a concession of the water segment from The Romanian Water System Authorities.

The sense of property is a psychological as well as financial element which stimulates the economical efficiency and foreign investment's protection. Enacting the property rights for foreigners to own land has increased the foreign investments in Romania. To support this theory we have below the statistics of direct investment's evolution over the last few years (Chart 1).

Chart 1

FDI in 1999-2006

Year	1999	2000	2001	2002	2003	2004	2005	2006	2007*
FDI value (bill. EURO)	1037	1147	1294	1212	1946	5183	5213	9060	7076*

*Source : Romanian Agency for Foreign Investment (ARIS), Country information, FDI statistics - <http://www.arisinvest.ro/level1.asp?ID=372&LID=1> in conjunction with BNR - www.bnr.ro - Publications – Monthly Bulletins, capitolBalance of Payments, pg.148-149; * provisory data*

If we take the cumulative foreign investments coming into Romania after 1999 we can see that Romania reached its purpose of bringing in over 10 bil euros in 2000-2004. The foreign investors have paid more attention to our national economy starting with 2003, when FDI has increased with 60% from 2000, this being a major growth, statistically speaking. Following 2003, great foreign capitals were brought in with the purpose of FDI. In 2004, FDI has grown almost 2.7 times compared to 2003, and in 2005 the intake of foreign investments was maintained at over 5.2 bil euro. The record value of FDI was reached in 2006, when this went over 9 bil euro.

The data from Chart 1 is just a start in analyzing the FDI because the FDI can actually be found in 4 different ways: (1) being part of the social capital, (2) the quasi-capital (net credit), (3) direct investments into tangible fixed assets and (4) investments into intangible fixed assets.

The foreign investments through the social capital of any firm are the most known, due to the data frequently recorded by The Trade Register, and their trend will be easy to follow. For the investors, this type of investment is also followed by a few restrictions. The first one is legal and it requires a minimum capital of 200 lei in order to establish a firm for a foreign investment. Then, there are the higher needs of financial funds (particularly in the beginning) which can be obtained from the banks. To make it easier, these will use Romanian banks, which also prefer clients with a high social capital. The higher the capitals of investors the more bonus points the bank will offer in order to obtain the funds.

The taxation law system will also have its impact on the investment's financial structure. An important and easy money source is also the loan from other company from the same group with a higher financial power. From there on, the best structure of own funds vs. loaned funds will be the major purpose of foreign managers to perfect their expenses in the light of interests calculated after taxes have been paid. Starting in 2005, the interests on loans from within the firm group became deductible, and this deduction was directly imposed by the amount of owned capitals compared to the amount of loaned capitals.

Below chart will show foreign investments by the size of total social capital and it includes the recording of capital through registering new companies every year, to this was added the capital increases and deducted the social capital recorded through erasing companies from The Trade Register every year. In 2003-2006 the size of total social capital at the end of each year was presented as national currency absolute value and its equivalent in foreign currency (euro), as well as continuous data, showing the yearly evolution.

We can see from the above chart that the social capital value, recorded by the foreign investors, has grown every year by 22%, according to the values in euro. It's confirmed, this way, that the investors did not chose to immobilize the capital as social

capital registered with The Trade Register due to the difficulty to repatriate the funds afterwards. They prefer to use loans from companies within the group, having a choice between non-refundable credits over a short or medium period of time and the choice of small interests or even equal to zero over a short or medium period of time.

Chart 2

Number of companies with partial foreign capital and the value of social capital recorded

Year	Number of companies		Value of recorded social capital		Value of recorded social capital	
	Number	%	Total in national currency		Total in equivalent euro	
			mil. ron	%	mil. euro	%
2003	97229	107.3	17755	132.8	8217	113.8
2004	107401	110.5	26834	151.2	9955	129.3
2005	119120	110.9	34007	126.7	12907	126.0
2006	131943	110.8	40654	119.5	15303	118.9

Source: Ministry of Justice , The Natinal Trade Register Office, Statistics - www.onrc.ro, http://www.onrc.ro/statistici/sr_2006_12.pdf, http://www.onrc.ro/statistici/sr_2005_12.pdf, http://www.onrc.ro/statistici/sr_2004_12.pdf, http://www.onrc.ro/statistici/sr_2003_12.pdf

Studying the number of companies registered with The Trade Register, we notice the same increasing direction with an average of 10% in 2003-2006. This is auspicious to developing this type of investments in the near future. And with all this, we cannot ignore the famous company restructuring systems with the sole purpose of taxation loss. The best known system is that of dividing the activity into companies paying taxes on the profit and companies paying taxes on income, after being categorized as micro-enterprises. This opportunity of fiscal strength makes the foreign investors establish more companies in Romania even though their activity remains the same.

Investments as quasi-capital (net credit) consist of the credits received from the firms created by the foreign investors or from the non-resident firm group that they belong to, less the credits obtain by the foreign investors from the company of direct investment or another firm from within the group. Foreign investors prefer this form of investment, due to the flexibility of repatriating the capital. The net credit will include all kinds of credits given by the foreign investors to their firms in Romania (long, medium and short grace period). Even though they have the legal instruments of a loan, these types of finances are very much alike with financing through social capital, is just that they are not registered with The Trade Register and the drawbacks are within the profit's limits.

Analyzing the types of capital, the FDI consist of: (1) owned capitals as equity stakes and net reinvested earning and (2) net credit. The FDI development according to its components (below chart) shows the investors' preference towards the equity stakes to the social capital, this being the 58.5% of the total FDI. In 2005 the investors preferred the external credit to the equity stakes to the social capital, this constituting in a decrease compared to 2004. The need of investing funds was covered by the external credits as well as the credits from the companies within the group they belong to. In 2006, the FDI increase was due to equity stakes as well as reinvested earnings. However, the equity stakes weight continued to decrease to 45.9% in favor of reinvested earnings growth to 29.5% of the FDI.

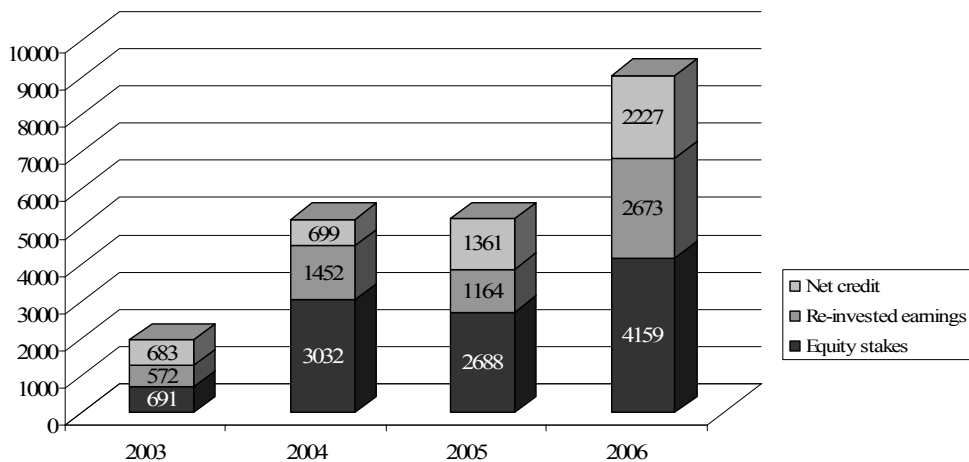


Figure 1 : FDI net inflow during 2003-2006

Source: National Bank of Romania, Statistics, Foreign Direct Investment - http://www.bnro.ro/def_en.htm

The same way we can analyze the FDI sold in the Romanian economics at the end of each year. The rate of equity stakes and the reinvested earnings increased in 2004 and 2005 to 80%, which offers certain stability for the FDI in Romania. The equity stakes and the reinvested earnings of the firms of direct investment reached, at the end of 2006, 27016 mil euro, representing 78.3% of the total FDI sold, and the net credit received by these firms from their foreign investors, including the credits from the group, reached 7496 mil euro, representing 21.7% of the total FDI sold.

On December 31st, 2007 the FDI in Romania has reached 41260 mil euros, out of which 30352 bil euro are the equity stakes and the net reinvested earnings, and 10908 bil euro are the net credit. This temporary info released by the BNR shows that at the end of 2007 the net credit went back to the performance from 2003, reaching 26.4%.

Chart 3

FDI evolution during 2003-2006

FDI Components	2003		2004		2005		2006	
	bil. euro	%	bil. euro	%	bil. euro	%	bil. euro	%
Equity stakes	6520	67,5	10555	70,2	16326	74,6	24343	70,5
Net reinvested earnings	572	5,9	1452	9,7	1164	5,3	2673	7,7
Net credit	2570	26,6	3033	20,2	4395	20,1	7496	21,7

Source: National Bank of Romania, Statistics, Foreign Direct Investment http://www.bnro.ro/def_en.htm

The investments in tangible fixed assets were not that frequent, all the same they are getting more and more defined. At the same time, we can speak of the same importance of investments in intangible fixed assets. However it's hard to analyze statistically this type of investment as there are no measurements. Transfers of technology, innovating ideas, systems of restructure and management are things that don't get recorded like the ones in The Trade Register. In spite of it all, it can be the

motor of a great business; it can make an investment become valuable, driving at the same time the development of life in general in that region, increasing the number of workplaces, through the taxes paid to the state and local budgets, social insurances etc.

Tangible fixed assets also play a very important role in economic development and they offer stability to foreign investments. Considering this, the chart below shows the evolution of these final destinations in the FDI sold, at the end of each year (Chart 4). We observe the growth in significance of tangible and intangible fixed assets during 2004 and 2005 reaching almost 60% of the total FDI, which attests the durability of FDI in Romania.

Chart 4

Tangible and intangible fixed assets during 2003-2006

FDI in:	2003		2004		2005		2006	
	bil. euro	%	bil. euro	%	bil. euro	%	bil. euro	%
Tangible and intangible fixed assets	4899	50,7	9082	60,4	12901	59	17174	49,8

Source: National Bank of Romania, Statistics, Foreign Direct Investment http://www.bnro.ro/def_en.htm

The FDI followed different industries in the Romanian economics. Considering a declining industry and agriculture in real terms of participation on gross domestic product, with a booming service field (which represents the bigger part of the economic growth) we have an almost 50%-50% circulation of FDI between industry and services.

Foreign investments turned mainly towards the manufacturing industry. And they could be observed at a rate of 51.1% in 2003, 45.7% in 2004, 37.3% in 2005 and 34.2% in 2006 in the manufacturing industry. Metallurgical engineering, food production, beverages and tobacco, transportation, cement, glass and ceramics, oil industry, chemicals, rubber and plastics are major focuses of the foreign investors. Foreign investments reached 15155 mil euro at the end of 2006.

Investments in activities that are centered in trade increased at almost 15% of the FDI in 2003-2005. A spectacular growth was also noticed in the financial industry and insurances, and as well in postal service, communications and networking.

Attention was drawn towards real estate and constructions only in 2006, when the value of FDI reached 2200 mil euro, meaning 6.4% of the total FDI.

Investments in public utilities, like water, drainage, energy (thermal and electrical) production and distribution started growing in 2005 due to the development of the private sector in these industries. I believe the success is mainly due to the input of the international financial institutions, which applied the financing plans. However, the level of these investments was very low compared to the needs in the Romanian economics.

The domains with a low input of the FDI were the clothing industry, leather and fur processing as well as hotels and restaurants.

The interest in agriculture was extremely low, representing only 1% of the FDI. In the period before we adhered to EU, the financing programs SAPARD had the sole purpose to attract Romanian and foreign investors into agriculture. Particularly the steps 2:1 and 3:4 were feasible for the small and medium investors. These programs should have made attractive the investments in agriculture; the investors could have had the benefit of non-refundable funds as high as the sum invested. And still, at the end of

2006, there were huge SAPARD funds not being used at all. The main cause was the lack of transparent communication towards the agriculturists regarding the steps to follow in order to obtain these funds.

The domains that registered the highest values of tangible and intangible fixed assets financed by foreign capital are the manufacturing industry, trade, postal service and communications and networking. In the manufacturing industry, the best were metallurgic engineering, food production, bevarages and tobacco and transportation. The fixed assets of the mining industry had an important growth in 2004 and from there on just a slow increase. In the energetic industry: electrical, thermal, natural gas and water the fixed assets financed by foreign capital registered important economic values starting in 2005.

Then we raise the question “how big was the FDI’s contribution to developing the fixed capital in the Romanian economy?”, when it is, even now, at a way lower technological level than the one in developed countries. Developing the Romanian economy implies continuingly adopting new technologies, that can compete with the international market and which should always protect the environment. We compared as such the development of foreign capital financed fixed assets in the Romanian economy over 2003, 2004, 2005 (Chart 5).

Chart 5

The development of foreign capital financed fixed assets in the Romanian economy
- bil euro -

Indicators	2003	2004	2005
Tangible fixed assets in Romanian economy	178998	136342	172422
Fixed assets financed by foreign capital	4899	9082	12901
Fixed assets financed by foreign capital weight in the total of tangible fixed assets in Romanian economy (%)	2,74	6,66	7,48

Source: Romanian Statistical Yearbook 2006, Chapter 12.8 Tangible fixed assets balance , p.440; National Bank of Romania, Statistics, Foreign Direct Investment, http://www.bnro.ro/def_en.htm

The value of the tangible fixed assets in the Romanian economy significantly declined in 2004, due to the fact that more fixed assets were eliminated than the ones coming in. This unfavorable situation determined the increase of foreign capital financed actives on the Romanian market. The input of FDI to help accumulating fixed capital for the Romanian economy is there for significant and growing, as opposed to the internal decrease of the fixed capital. In 2005 there is an increase of the in-house financed capitals, but still under the records of 2003. The FDI continued financing the accumulation of fixed capital, and foreign immobilizations reached 7.48% of the total of immobilizations in the Romanian economics.

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