WAYS OF IMPROVING FOREIGN DIRECT INVESTMENT (FDI) CONTRIBUTION TO ROMANIA'S SUSTAINABLE DEVELOPMENT

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ABSTRACT: The paper analysis the macro and micro ways of improving FDI contribution to Romania's sustainable development. Part.1 is devoted to FDI macroeconomic factors of influence regarding: theoretical and practical aspects of sectoral structure and technological level of FDI; regional and country of origin FDI distribution in the host country; reinvested and repatriated profits; FDI impact on trade balance. Part 2 is devoted to some measures at macrolevel deserving more attention in order to increase mutual and more equitable advantages of all stakeholders involved in FDI activity such as transfer pricing, financial and banking relation between affiliates and parent company, royalty payments and barter trade relations.

Keywords: FDI structure and types sustainable development, reinvested, profit, repatriate profit, transfer prices.

JEL Codes: O1, O3, D4, F21, F23, F32, F4, G34

Introduction

The present paper focuses on the relationship between FDI impact and economic evolution of host country, with in our special case Romania.

Although FDI stock in Romania is rising over the transition period 1990-2012 their the economic acid social impact remains unequally distributed from the spatial and sectoral standpoints.

An in depth FDI analysis of Romania FDI effects needs to identify the main challenges in obtaining higher positive macro and micro impacts for Romanian economy, under the conditions of „win-win" hypothesis and shed light on ways of further improvements in effective use of FDI opportunities.

Based on the analysis of best practices and international regulations and experience in FDI domains, we try to examine the role of foreign capital in providing valuable and long lasting incentives to the value added creation at micro and macrolevels in Romania.

The main objectives of our paper regard FDI role in the Romanian economy its policy context and governance taking into consideration the balance between short, medium and long terms both in host country and origin one, in accordance with the requirement of sustainable development for all.

At the same time, the research offers a series of recommendations to develop the Romania's economic and social competitiveness and gain from participating in different, components of globalization process directly or indirectly related to FDI.

Based on the SWOT analysis principles, the paper shows how Romania could obtain short, medium and long term benefits from the complementarity between domestic and foreign capital, in order to reduce economic and social inequalities, boost ecoefficiency, improve employment prospects and standard of living.

If major part of studies devoted to FDI domain are mainly analyzing the favourable effects, in our paper we intend to delineate and discuss ways and factors of increasing favourable impact of

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FDI in our country by reducing or combating their potential and/or real direct and indirect disadvantages, having in view a series of aspects regarding weaknesses and risks of FDI for destination country, in general, and for Romania, in particular.

The analysis of a body of various literatures on FDI reveals that FDI in host emergent developing countries is still a matter of scientific debate and practical concern.

The debate of the many new challenges and issues of FDI to date is very much influenced by the current economic and financial crisis at national, regional and international levels.

In this respect it is worth mentioning to point out that economic crisis showed on the possibility of reversibility dismantling of processes and phenomena not very long time ago considered as irreversible such as euro zone integration as international hierarchy of economic power as supremacy.

FDI strategies at national and international levels are facing intensifying challenges and rapid changes for origin and destination countries with different effects depending on economic development of countries, specifics of governance, factors endowment etc.

UNCTAD, OECD, EUROSTAT, National Bank of Romania and National Institute of Statistics were the authoritative source for relevant and accurate statistical information on the stats of FDI volume, dynamics, regional and sectoral structure.

The main objective of our paper consists in providing academics, decision makers and other stakeholders with more relevant aspects and influence factors they need for monitoring, adjusting or/and changing FDI policies.

The paper is organized as follows. Part one is dealing with general theoretical as a macroeconomic factors of FDI that could be better used by host countries in order to increase their support in improving economic, social and environmental performances of the host countries.

Part two is devoted to some measures, instruments and mechanism, at microlevel deserving more attention for increasing equitable and mutual advantages of stakeholders involved in FDI activitity.

Our research is intended to contribute to a more in-depth debate about a realistic and more objective evaluation of FDI economic effects from the perspective of sustainable development, smart and inclusive society.

Part one – Macroeconomic aspects of FDI

1. FDI intradable and nontradable sectors

In Romania, the most important part of FDI is **located in non-tradable and services sectors**. This shows the high interest of foreign investors for using relatively cheap local labour and raw materials or some other comparative advantages concerning financial opportunities such as (high interes rate, forex advantages etc.). That means the interest of foreign investors to use offered opportunities in Romania for exporting their technology and selling the results of their output on the domestic market or to get more profits by exporting their goods and services produced by their affiliates in the host country.

Foreign investment in non-tradable sectors does not contributes to the increase of export and external competitiveness. On the other hand, FDI companies in non-tradable sectors are more competitive that national economic agents that means a threat for domestic small scale industries that easily case be pushed out of the business.

That is why the state in the host country has the obligation to limit the negative impact from FDI especially in the case of special sector as those of national securities or defense.

FDI bring a higher competition in the **domestic market.** For the host country, this can be beneficial on the one hand because stimulate competition, productivity and efficiency. On the other hand, we should not neglect the detrimental impact for national economy due to removal of an important segment of domestic economic agents which disappeared because of their in capacity of reconversion and adaptation to the new conditions and requirements of free market-based economy.

2. Technological level of FDI in Romania

Promoting sector with high technological level by the aid of FDI seems to be a general requirement for continued sustainable development of countries. In Romania the major part of FDI (more than 80%) belongs to medium and low tech level branches. This impose for Romanian FDI policies a more selective approach in promoting foreign investments in the high tech level sectors with larger value added and stronger competitiveness, using a series of incentive and adequate measure to boost high technology transfer and generation.

As results from table 1, the index of high-technology manufacturing production over the whole period 2000-2011 was negative while the medium high-tech and low-tech levels of manufacturing production increased by 2.7 and respectively 1.14 times.

Table no.1.

Volume index of production by technology level (2000=100) – România

Year	High-technology manufacturing	Medium high-technology manufacturing	Low-technology manufacturing	Medium low-technology manufacturing
2000	100.00	100.00	100.00	100.00
2005	81.31	135.32	103.76	97.12
2006	95.03	156.83	113.28	112.29
2007	97.97	183.05	121.55	129.99
2008	106.62	190.01	117.99	139.74
2009	83.40	200.53	111.70	115.98
2010	87.06	248.98	111.13	114.24
2011	90.09	277.26	114.97	119.65

Source: Own calculation based on EUROSTAT data.

Figures in the table 1 show a very unfavourable decrease by 10 pp in the period 2000-2010 of the volume index of production in high-technology manufacturing what confirms the low influence of FDI in Romania in this important sector for sustainable development and R&D competition capacity of Romania's economy.

The most relevant increase, however of output is registered in medium high-technology manufacturing (2.7 times) what could be considered as a necessary but not sufficient condition as a necessary sustainable growth premises.

The technological level of economic sectors from the ISD share in Romania shows that sector characterized by the high tech technological level are representing only a small part (around 4.5 per cent) in the total volume of FDI and exports. This is a clear structural shortcoming (disadvantage) of the Romanian economy that needs to be solved as soon as possible, taking into account the rapid changes of tehnological progress at national and international levels and the necessity of inducing a "catching up" and "leapfrogging" trends in the Romanian economy evolution.

The involved decision makers, especially the Government and other public institutions, have to be more selective in opening sectors for FDI paying a special attention to high tech branches where our national economy could have the best comparative and competitive advantages, combining its internal and external strong points and opportunities on short, medium and long terms. In this direction the "reindustrialization" policy in Romania has to be reoriented towards incentives of intra branches specialization (Grubel-Lloyd Indices) and favourable international value chains with higher value added proportion.

An important contribution in solving this difficult problem has the capacity of Romanian stakeholders to identify the determinants of innovation national system able to cope with both external competition and propensity of MNC maintain R&D activities in their headquarters.

3. FDI types: mergers &acquisitions and "greenfields"

Distinction of FDI between mergers & acquisition, development of existing foreign companies and green fields investment shows the predominance of the first two types New FDI of Greenfield has a very small share in the total volume of FDI that means is a clear disadvantage for Romanian economy because:

- greenfield investment increase the size of new job creation, offering a better opportunity for social self-protection;
- usually greenfield companies are directly linked to new technologies products and service enhancing the competitiveness of national economy.

Present and past experience of state-owned enterprises (SOEs) privatization in Romania showed that M&A and development investment have substantially reduced the number of employees and very often, the profile of production. At the same time R&D sectors of newly privatized companies have been removed. In other words, the economic and financial conversion via privatizations with so-called strategic investors were not to a good part of them a "success story".

4. FDI territorial distribution

The present situation of FDI regional distribution in Romania is characterised by sensitive disbalances and inequalities. For instance the development Region Bucharest – Ilfov represents more than 60 per cent of the total FDI volume, followed by Region South Muntenia (7.3 per cent), Region West (6.5 per cent) and Region South East (6.3 per cent). The high level of FDI concentrates in the Region Bucharest-Ilfov rise the problem of the role of foreign capital for economic convergence/divergence process in Romania.

The theory of "J" shape curve of S. Kuznets could be an argument only for initial stages of transition but not for a very long-time periods. The current economic crisis seems to have deepening effects of regional economic and social gaps and inequalities, in spite of financial contribution of EU Sectoral Operational Programme at regional level.

In conclusion, a special emphasis should be put on the development via FDI in Regions South West and North East where foreign capital has registered modest levels.

Here again we consider that FDI policies in Romania have to find out economic and financial mechanisms for reducing the discrepancies and gaps at regional levels following a special strategy for FDI encouraging in less developed regions and counties of Romania, promoting the "pôles de croissance" and other regional technological diffusion centers.

5. A more balanced FDI distribution by countries of origine

Romania integration into EU-27 had as one of the most out standing effect the increase of the member-states importance for our external economic relations. EU countries represents the first economic partner of Romania and with a share of more than 70 per cent in the total volume of Romania's FDI. The first positions are occupied by Netherlands (20.7%), Austria (17.8%), Germany (12.2%), France (8.3%), Greece (5.7%).

The current economic crisis revealed the necessity to approach in a more complex manner the strategy of conceiving and implementing external economic relation between Romania and intra and extra EU 27. The difficulties of Euro-zone, as a result of the crisis of sovereign debts for some countries, the general economic crisis situation within EU-27 impose to be more cautious and concerned with the long time aspects of Romania's unilateral and asymmetric dependency on EU-27. The economic potential of extra EU-27 countries under the conditions of globalization and current crisis could be an important complementary variant to a certain extent.

The idea is to seek new external markets, more convenient for Romania, taking into consideration that an objectively determined “saturation limit” of Romania - EU 27 commercial and economic relations could exist. In this sense, it is useful to reinforce some traditional economic relations, including FDI, in the extra UE-27 area (USA, Russian Federation, China etc.).

6. A key FDI problem: reinvested and repatriated profit.

One important aspect of maximizing long term, effective complementarity and synergy between foreign and domestic production factors is concerning the relationship between FDI reinvested and repatriated profits. According to our estimation, based on World Investment Report 2012, the percentage share of FDI repatriated profits at world level was 75.5% in 2009 and 60% in 2010, the rest up to 100% being reinvested profit.

The crisis impact on FDI profits changes the absolute level and relative share of expatriated profits. We notice an increase in percentage share of reinvested FDI earnings while their absolute size has severely diminished.

Over the period 2003-2010, the total volume of repatriated profit of FDI operating in Romania has amounted to Euro 14.112 billion, the total FDI stock in 2010 being of around Euro 52 billion. This means that for the whole analysed period an approximately one third of total FDI profits in Romania has been reinvested and the remaining two thirds were repatriated. This put in evidence the high rate of FDI efficiency in Romania, in general, and for the foreign investors, in particular.

World Bank data (http:businessday.ro/12/2010) indicate that in the period 2005-2009, MNC subsidiaries located in Romania have expatriated around USD 19 billion Euro. In 2009, the first crisis year the amount of expatriated profit has dropped by 65 per cent as against the previous year.

We consider that one of ways for improving the FDI contribution to Romania’s exit from crisis and relaunching sound economic growth consists in **increasing the part of reinvested FDI profit in the host country,** especially for developing productive capacities in manufacturing industries and not for creating some “buffer funds” serving for unpredictable situation or speculative activities on financial markets in Romania.

On the other hand it is necessary to study the possibility to allow the profit repatriation only after economic agents with foreign capital have paid all their financial obligation (taxes, fees etc.) for the state budget or other public institution in Romania.

We consider that the relationship between reinvested and repatriated profits has to be analysed in a larger context taking into consideration FDI positive and negative externalities for third parties which are in their major past domestic economic entities. In this respect, a more detailed research of FDI impact using special econometric models, such as VAR for example, could be very relevant for a better under standing of the influence and effects of vertical and horizontal FDI, of the interdependence between GDP, exports balance of external payments and volume and structure of FDI etc.

7. FDI and foreign trade of Romania

The domain of FDI **effects on foreign trade** of a national economy is generating long and very interesting debates from viewpoints both theoretical and practice.

Analysis of statistical data on FDI and impact on Romania’s exports and imports shows that, in 2009, a share of 70.8 per cent of exports and around 60% of import of the total foreign trade in Romania are under control of foreign capital. This is a clear evidence of the real fact the MNC and foreign capital has a very important position for the evolution of Romanian economy. From this FDI dominant position it result not only opportunity and benefits for foreign investors but economic and social responsibility too.

During the period 2007-2010 the trade balance of economic agents with foreign investment participation in Romania recorded each year commercial deficits (imports larger than exports) of respectively:

- 9.139 billion euro in 2007;
- 11.588 billion euro in 2008;
- 2.882 billion euro in 2009;
- 2.231 billion euro in 2010.

It turns out that FDI in Romania, at macroeconomic levels, are importing more than exporting. In fact this means a negative impact on trade balance, current account and balance of external debt payments. These detrimental disequilibria were accompanying Romanian; economic evolution practically the whole transition period to market economy, what confirms that FDI and this foreign trade activity where not contributing to commercial balance improvement of Romanian economy and sustainable development of our economy.

The sectoral analysis of foreign trade balance shows that the main responsible for commercial disbalance in 2010 were mainly the following branches: commerce (-4.643 billion euro); oil precessing; chemicals, rubber and plastics processing (-1.467); food, beverage, tobacco (-0.661); IT&C (-0.428).

The above mentioned figures suggest undoubtedly that a more favourable effect of FDI in Romania could be obtained by means of a more rapid increase of exports in comparison with import growth rate, especially in the domains where Romania has evident and practically proved potentialities in the past period in relations with developed and developing countries.

In conclusion we can point out on the necessity to improve Romania's export capacity with the contribution of so-called vertical FDI which have a more powerful upstream and downstream propagation effects on national economy, in comparison with horizontal FDI.

A particular interest both theoretical and practical for Romania results from the fact that foreign trade forecasting for Romania in the next five year predicts a continued growth of trade balance deficit (-13.51 billion euro in 2014; -15.35 billion euro in 2015; - 17.1 billion euro in 2020. The national strategies of exports have to pay very urgent attention to priority setting and action plans aiming at improving commercial balance in the future for the sectors where Romania has the necessary economic and social potential (for example food and agriculture production, some branches of manufacturing industries etc.). The prospects of permanent increase of commercial deficit in Romania is in evident contradiction with the sustainability principle.

Part two. Microeconomic improvement of FDI contribution.

Transfer prices between parent firms and their subsidiaries represent a complex factor of bilateral economic and financial relations between MNC and their subsidiaries which generate a series of problems concerning the advantages of FDI for origin and host countries.

Although this domain is regulated by EU and national legislations, many practical aspects of non-market, preferential pricing are detected.

Some parent firms import from their subsidiary goods and services at lower (preference) prices and export to subsidiaries at higher prices what create, as a rule, non-justified advantages for MNC. The methodology instructions of supervising and controlling transfer prices in Romania are less implemented due to a series of subjective and objective factors.

A more rigorous control of transfer prices, in accordance with the existing legislation, is also a factor improving FDI contribution to economic development of host country. The main responsible in this domain is the Ministry of Finance in cooperation with other ministries.

Financial and banking relations between parent companies and subsidiaries can favour MNC in case of credits and loans interest rates period of disbursement and forex currency speculation.

Lagging and leading payments between the subsidiary and parent company can generate unilateral advantage for parent-firm depending on evolution of currency exchange rate (appreciation and depreciation of national currency).

The strict supervising of these practices can stop or reduce the profit transfer from subsidiary to parent company. The subsidiaries of the same parent firm can help each other by the so-called parallel inter company loans.

Royalty payments are in fact a sort of hidden type of profit transfer in case the parent company is charging the subsidiary with a certain amount of royalties in case trademarks and intellectual property rights of parent firm are used by its subsidiaries.

The **barter-trade relation between parent and subsidiary** can also generates advantages for parent by means of the differences between the value of received and sent goods with out interferences of payment systems and prices.

A further careful study of the above mentioned ways of improving FDI contribution to sustainable development of Romania economy represent a necessary support in effectively handling benefits to all involved stakeholders in the origin and destination countries. In this context, the final FDI aim is the welfare and poverty reduction for all.

Analysing the relation between FDI and poverty alleviation, many specialists such as J. Stiglitz, A. Mold etc., consider that poverty relief depend far more on the domestic efforts of countries and effective modiblization of their own resources, “than on the flow of aid and international investment” (Stamp M, 1974, cited by A. Mold).

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