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Foreign Direct Investment in Romania Before, During and After the Coronavirus Pandemic

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Abstract: Foreign direct investment plays an extremely important role in the Romanian economy. If in 1990 the Romanian economy registered a low productivity and competitiveness, today it looks completely different. Romania has competitive sectors at regional and even global level, has been integrated into international production chains and exports high quality products. These things would not have been possible without the foreign capital that contributed funding and know-how and helped Romania to enhance its competitive advantages and well-trained workforce. In this paper we aim to make a retrospective of foreign direct investment in Romania before and after the coronavirus pandemic if we can consider it completed and identify the most attractive regions for investment in Romania.

Keywords: investments; attractiveness; competitiveness

JEL Classification: E22; E61

1. Introduction

European Investment Bank grants credits to mostly to countries that are members of the European Union but not only to them. Foreign direct investment (FDI) is one of the main sources of development of an economy. On the one hand, they are complementary to public investments and those made by residents from private sources, and on the other hand, they stimulate the development of both the enterprises in which they invest, as well as the enterprises of the resident economy with which they enter into economic relations (NBR, 2022).

The Organization for Economic Co-operation and Development (OECD) has identified five main channels through which a country's economy is influenced by FDI, namely (BNR, 2022):

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represents an important source of innovative technologies and knowledge of work flow organization (know-how);

contributes to the development of enterprises, as well as to their restructuring;

contributes to the development of international trade and integration into the world economy;

contributes to stimulating and increasing competitiveness;

creates jobs and contributes to the development of human capital.

2. Analysis of FDI Evolution Before the Coronavirus Pandemic

The analysis of the evolution of the components of the net flow of FDI reveals the following:

– the reinvested profit had an upward evolution in the last 10 years. Thus, from negative values of over 2,000 million euros in the first two years of the analyzed interval, the reinvested profit recorded positive values starting from 2015 (+510 million euros), reaching 2,783 million euros in 2019, an increase of 8.2 percent compared to 2018;

- debt instruments had positive values until 2013. Starting with the following year, they alternated positive values with negative ones;

– until 2018, the largest contribution to the net flow of FDI was registered by the contribution to own capital component, with a maximum of 4,222 million euros in 2014 and a minimum of 2,235 million euros in 2017, being surpassed in 2019 by reinvested profit.

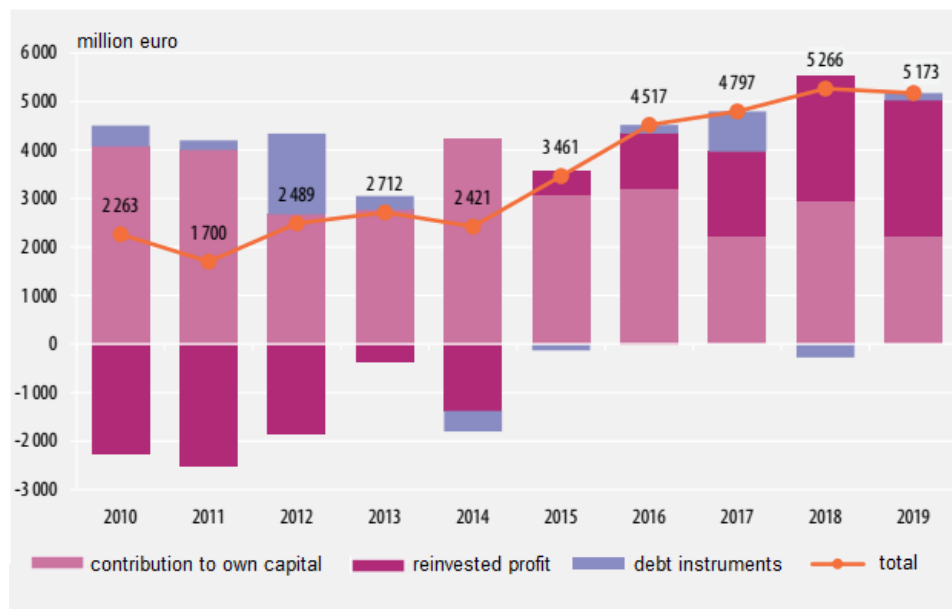


Figure1. Evolution of the Net Flow of FDI by Component in the Period 2010-2019

Source: NBR, Foreign direct investments in Romania in 2019, Bucharest, 2020.

The analysis of the net flow of FDI in relation to the gross domestic product (GDP) reveals the fact that it mostly recorded an ascending trend with some oscillations in 2011, 2014, and the starting with 2017 it decreased continuously, due in particular to the sharp increase in the nominal GDP expressed in euros (For example in 2019: +9.1 percent compared to the previous year).

Relative to the total resident population, the net flow of FDI recorded until 2014 registered approximately the same fluctuations as the net flow of FDI relative to GDP, and subsequently it had an upward trend with a slight decrease in 2019, to the value of 267 euros/inhabitant, compared to 270 euros/inhabitant in 2018 (Figure 2).

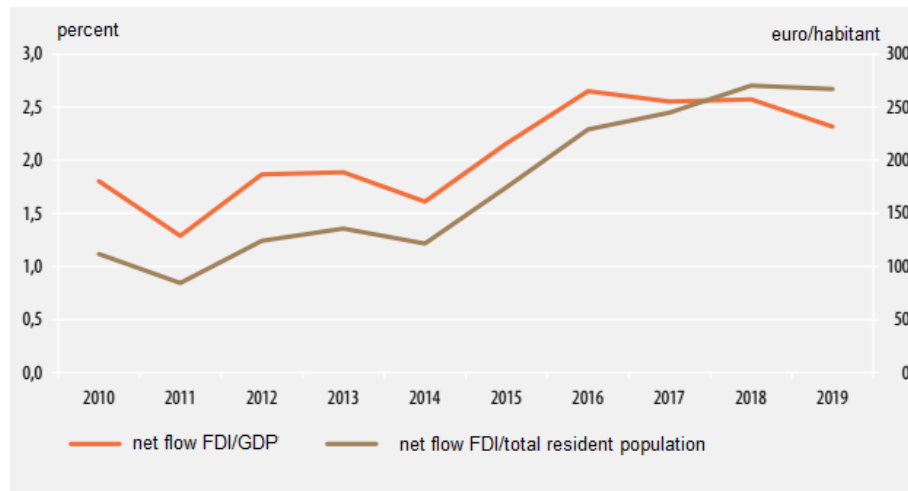


Figure 2. Evolution of the FDI/GDP Flow, Respectively the FDI Flow/Total Resident Population

Source: NBR, Foreign Direct Investments in Romania in 2019, Bucharest, 2020.

From the point of view of the balance of foreign direct investments, compared to 2010, in 2019 the total balance of FDI increased by 71.8 percent, both components registering similar growth rates (72.4 percent equity, 70.2 percent one hundred debt instruments) (Figure 3).

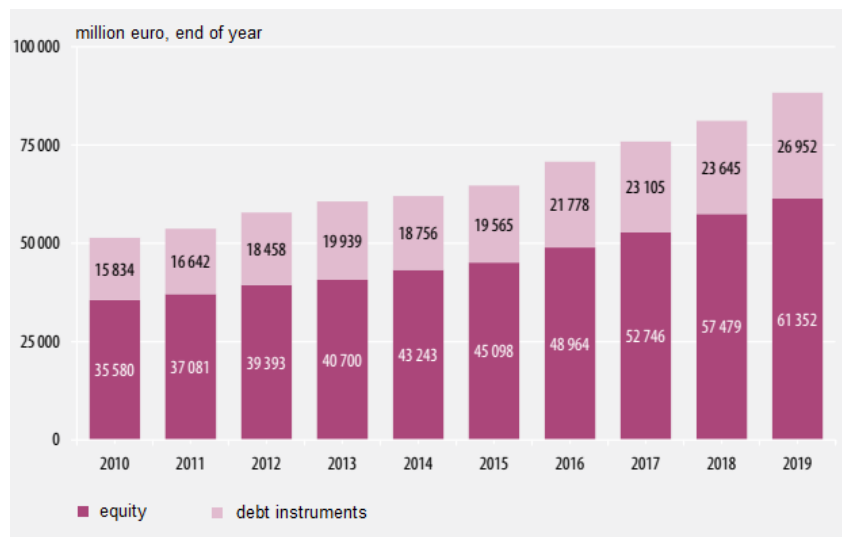


Figure 3. Evolution of the Components of the FDI Balance in the Period 2010-2019

Source: NBR, Foreign direct investments in Romania in 2019, Bucharest, 2020.

From the point of view of the FDI balance compared to the Gross Domestic Product, its trend was downward for most of the analyzed period, with the exception of some

positive oscillations in 2012 and 2016. In 2019, the last year before the pandemic, the FDI balance compared to the Gross Domestic Product recorded the value of 39.5% (-0.1 percentage points compared to the previous year), due to the higher growth rate of the nominal GDP expressed in euros (+9.1%) compared to the balance FDI (+8.9 %).

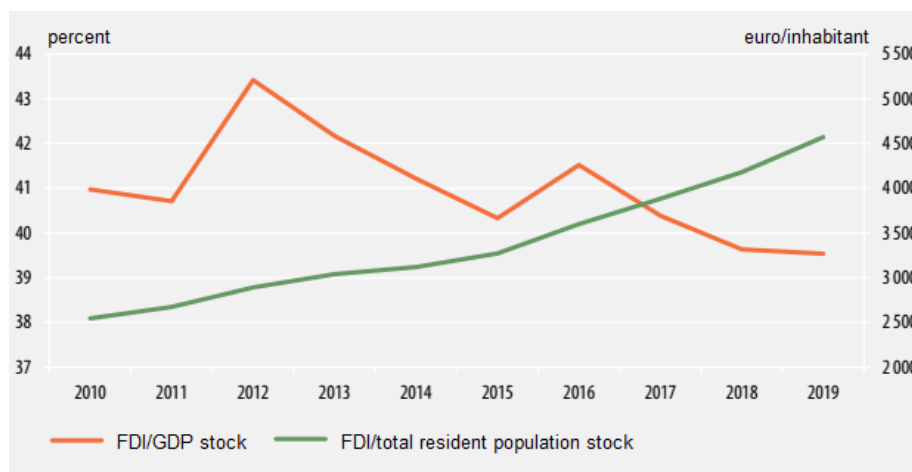


Figure 4. Evolution of the FDI/GDP Balance, Respectively the FDI Balance/Total Resident Population

Source: NBR, Foreign Direct Investments In Romania In 2019, Bucharest, 2020.

Relative to the total resident population, the FDI balance had an upward evolution in the period 2010-2019, increasing from 2545 euros/inhabitant in 2010 to 4571 euros/inhabitant in 2019. The positive evolution was due not only to the increase in the stock of foreign investments, but also the decline of the resident population.

Thus, in the last 10 years, the FDI/GDP balance had an oscillating evolution, while the FDI/inhabitant balance registered a continuous increase.

From the point of view of the orientation on economic activities, the largest percentage of the total balance of FDI was located in industry, in all the localized period. Industry was followed by construction and transactions, trade and financial intermediation and insurance (Figure 5).

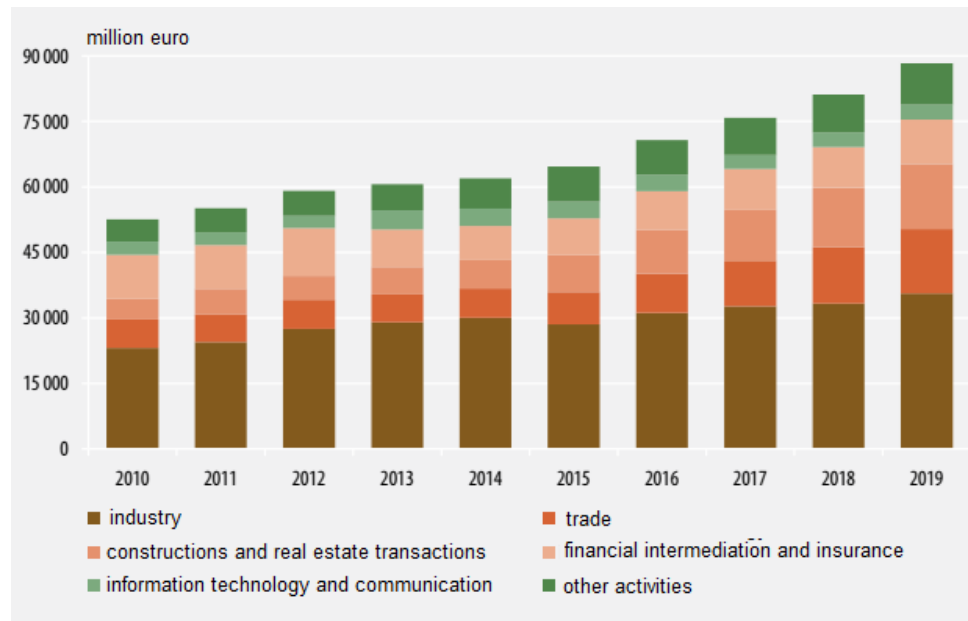


Figure 5. Evolution of the Total Balance of FDI Detailed by Activity Sector

Source: NBR, Foreign direct investments in Romania in 2019, Bucharest, 2020.

3. Analysis of Foreign Direct Investments in Romania During and After the Coronavirus Pandemic

The international epidemiological situation generated by the emergence of the SARS-CoV-2 coronavirus significantly influenced the economic environment during 2020. The declaration of the pandemic by the World Health Organization (WHO) on March 11, as a result of the spread of the virus in over 150 countries and, subsequently, the declaration of the state of emergency in Romania were the main causes for the registration in 2020 of a negative net flow of foreign direct investments (FDI). (NBR, 2021)

The rapid spread of the virus globally has led the affected states to take measures to prevent and limit its spread, imposing restrictions on the movement of the population. The activity of many FDI enterprises has been affected due to the disruption of the supply processes of raw materials, materials and subassemblies, given that most subsidiaries of large multinational groups are integrated into global value chains. Under these conditions and to protect employees, many affected FDI enterprises, which did not produce food or strictly necessary goods, decided to suspend their activity. The suspension of the activity led both to the accumulation of losses by the FDI companies, thus determining the decrease of their own capital, and

to the suspension or postponement of the investment projects being carried out or that were to be started in these subsidiaries during 2020 (NBR, 2021)

In 2020, the net flow of FDI recorded the level of 3,005 million euros, down 41.9 percent compared to 2019.

In structure, the net flow of FDI registered the following values:

equity participations of direct foreign investors in enterprises of foreign direct investment from Romania, worth 3,999 million euros. Equity to own capitals are made up of the contribution to the capitals of FDI enterprises, in the amount of 983 million euros, to which is added the reinvested profit, in the amount of 3,016 million euros;

debt instruments in the relationship with foreign direct investors and companies from within their group, having a negative value of -994 million euros.

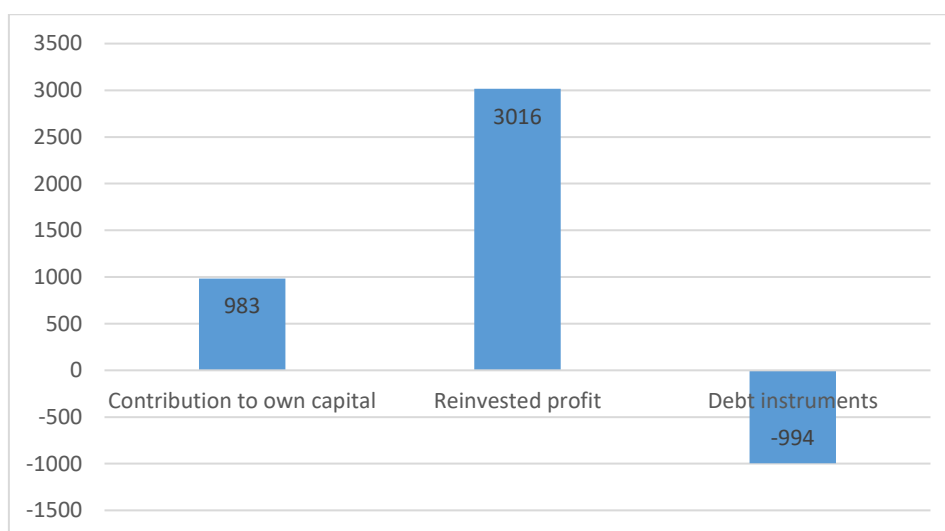


Figure 6. Net FDI Flow by Component in 2020

Source: realized by the author based on the data from NBR, Foreign direct investments in Romania in 2020, Bucharest, 2021.

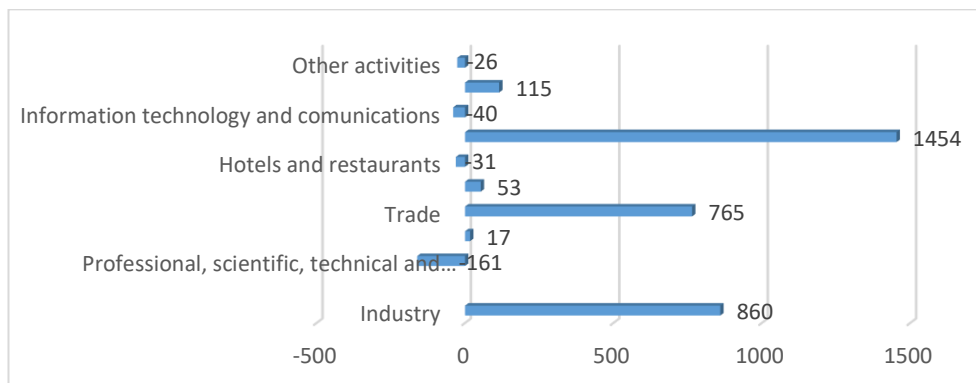


Figure 7. The Net Flow of FDI in 2020 and Its Components by Fields of Activity of FDI Enterprises

Source: realized by the author based on the data from NBR, *Foreign direct investments in Romania in 2020*, Bucharest, 2021.

From the point of view of the distribution of the components of the net flow of FDI by fields of activity, financial intermediation and insurance (1454 million euros), followed by industry (860 million euros), commerce (765 million euros) and transports (115 million euros).

A negative flow was recorded by professional, scientific, technical activities, support services (-161 million euros), information technology and communications (-40 million euros), hotels and restaurants (-31 million euros) and other activities (-26 million euros).

The decrease in the net flow of FDI in 2020, mainly generated by the emergence and spread of the SARS-CoV-2 virus, also negatively influenced the share of the net flow of FDI in the gross domestic product (GDP). Thus, although in 2020 the value of nominal GDP expressed in euros decreased by 2.3% compared to 2019, the FDI/GDP net flow ratio recorded the value of 1.4% of GDP, down from 2.3 in 2019. Relative to the total resident population, the net flow of FDI recorded the value of 157 euros/inhabitant, also decreasing from 268 euros/inhabitant in 2019 (BNR, 2021).

If we refer to the balance of foreign direct investments, it recorded the level of 90,773 million euros in 2020. The decrease in the value of the net FDI flow in 2020, compared to previous years, mainly generated by the negative economic effects of the health crisis, also influenced the growth rate of the FDI balance. Thus, at the end of 2020 it registered an increase of only 2.8% compared to 2019.

The structure of the total FDI balance in 2020 included:

equity (including accumulated reinvested profit): 63,952 million euros, representing 70.5% of the total FDI balance, up 4.2% compared to 2019;

debt instruments: 26,821 million euros, representing 29.5% of the total FDI balance, down 0.5% compared to 2019;

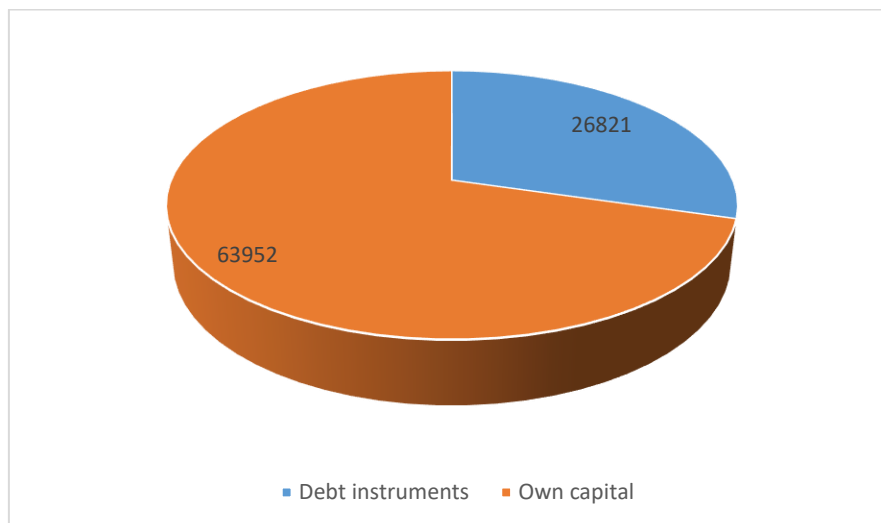


Figure 8. Distribution of FDI Balance Components in 2020 (Million Euros)

Source: realized by the author based on the data from NBR, *Foreign direct investments in Romania in 2020*, Bucharest, 2021.

4. The Situation of Foreign Direct Investments in Romania Under the Influence of the War in Ukraine

In May 2022, the Council of Foreign Investors published the CFI Business Sentiment Index report, from which it follows that there are still intentions and projects for foreign investments in Romania: half of the respondents estimate that for this year the planned investments are at levels similar to of last year, and 40% of respondents say they plan to invest larger amounts compared to the previous period. (Foreign Investors Council, 2022)

The NBR reports on the first quarter of 2022 confirm the CFI surveys: direct investments made by non-residents in Romania increased by 9.7% in the first two months of 2022, to 926 million euros, compared to 844 million euros in the same period of 2021.

But as soon as the war started, things changed. FDIs were blocked or delayed. The question is how quickly the Romanian economy will move in order to favor accessing the new opportunities created by the war, namely the boost that it is clear that businesses in the defense industry must receive and the correct placement to be able to participate in the near future to the reconstruction of Ukraine?

Therefore, tax legislation must be accessible and predictable: how do investors interact with the tax office, with the customs system, what fees and taxes do they

pay, etc.? Last but not least, what is the legal and regulatory framework in case the business gets into difficulties? ie: available aids, pre-insolvency, insolvency or bankruptcy procedures. Because the changes now in the markets are so fast that the probability of having difficulties in running the business is high.

EY Romania, in the EY Attractiveness Survey, 2021, records that the main factors that investors consider in their future investments in Romania are:

the quality and degree of development of the infrastructure,

safety and security measures initiated to prevent or successfully confront future crises and

the level of technology adoption and integration.

The changes that EY recommends, to keep Romania attractive to foreign investors, can be grouped as follows (EY, 2021):

Priority given to digital transformation: 92% of international investors stated that the availability of a workforce with technological skills is an important factor in determining the destinations of their investments.

Development of logistics services and production sectors and investments in reliable infrastructure: 52% of investors would consider an investment in Romania, if the infrastructure proved reliable and had good coverage. To attract investors who are currently reluctant to expand their operations to other countries, infrastructure investment could prove crucial.

Supporting small and medium-sized enterprises and focusing on incentives and attractive fiscal policies: most investors rated the support given to SMEs as the main aspect that Romania needs to focus on in order to become more competitive in the global economy.

Greater attention to environmental and sustainability policies: 86% of investors consider environmental sustainability to be of medium importance in their investment strategies. Europe's ambitious plans to be carbon-neutral by 2050 and cut greenhouse gas emissions by 55% by 2030 could create numerous opportunities for foreign investment.

Supporting labor and skills development: Human resources are often considered the most important factor for investors in evaluating a country as a potential destination for FDI. Supporting the local workforce is an imperative for any country aiming for economic growth, as a skilled workforce is a key factor for any foreign investor.

Conclusions

As a result of the war in Ukraine, Romania will gain in terms of profits and the level of technology, but will lose in terms of the investment appetite of foreign capital, because the area becomes dangerous. In this context, it is required that Romania think of a business plan for foreign investments that is totally different from the one up to now, which will satisfy the fear of investing in a warm area through massive economic advantages.

Under the pressure of reality, Romania must not only continue to attract foreign investments but also structure them appropriately. First, the infrastructure must be improved and then the focus must be placed on increasing the quality of education and the high qualification of the workforce, concomitant with taking measures to preserve it in the country, improving wages and quality of life.

Investments must be directed towards the area of production, reindustrialization, increasing the weight of research and innovation as a factor of production, decreasing the importance of areas with low added value and increasing the competition that domestic capital has with foreign capital in strategic sectors.

Considering the global reorientation of FDI flows towards services, largely supported by technological developments, this is an opportunity that our country has not yet managed to capitalize on, having the lowest share of FDI in the field of services compared to neighboring countries.

FDI must be attracted taking into account strategic criteria that presuppose the adoption of complementary measures, namely: increasing the capacity of local companies to assimilate knowledge and technological developments from foreign investors and directing FDI to fields with high added value.

Romania must do what other states in the region (Poland, Hungary, the Czech Republic) have been doing for a long time: have a real industrial policy and one that is focused on bringing investors to areas where Romania has a comparative or competitive advantage and investments with high added value. It is the only way in which productivity and therefore the salary level in Romania will increase significantly. The industrial policy must be made by the Government at the central level but also in collaboration with strong sector associations that understand their industries, chains and that can help in identifying relevant investors.

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