

INTERNATIONAL INVESTMENTS PROSPECTS FOR THE PERIOD 2007-2009. POSSIBLE EFFECTS ON THE ROMANIAN ECONOMY

Prof. PhD. Ana POPA
Assoc. Prof. PhD. Laura GIURCĂ VASILESCU
University of Craiova

1. Introduction

After a decline in the early 2000s, FDI flows have been rising continuously since 2003, with an acceleration of this trend in 2007. Therefore, the global FDI inflows increased in 2007 up to \$1537.9 billion - which represents an expansion of 17.8% compared to 2006.

This increase is reflected in various indicators such as number and value cross-border merger and acquisitions (M&As), Greenfield projects and the number of jobs created abroad.

According to the UNCTAD survey, this trend should continue up to 2009.

The prospects for the South-East Europe and the Commonwealth of Independent States (CIS) are also optimistic. This region ranks fourth in the world as a preferred investment location for transnational companies (TNCs).

Generally, a large proportion of the companies indicated that they were considering increasing their investments there over the period 2007–2009.

At the same time, global external imbalances, sharp exchange-rate fluctuations, rising interest rates and increasing inflationary pressures, as well as high and volatile commodity prices, pose risks that may have a chilling effect on global FDI flows.

For example, in Romania, FDI inflows declined to \$9 billion in 2007 (which is less than 21.3%, compared to 2006).

World Cross border M&As activity already declined in the second half of 2007.

In fact, UNCTAD has a controversy attitude about the FDI related prospects into South-East Europe and the CIS and it offers a mixed prospect for the period 2007-2009.

2. Highlights global trends in FDI and determinants of future FDI flows

A large proportion of companies expect to increase their investments abroad over the period 2007-2009.

The possible rise in FDI flows (both in absolute terms and compared to total investment) can be explained by three major factors:

- a continuation of the prevailing long-term trends that are conducive to the internationalization of companies;

- a short - to medium-term economic outlook, characterized by sustained growth and availability of financial resources;

- the emergence of new sources of and opportunities for investment

In fact, there are three main motives for companies to internationalize their production activities such as:

- market-seeking;
- resource-seeking;
- efficiency-seeking.

In addition, the existence of open, pro-business and stable investment environments in a growing number of locations encourages foreign investment.

The main factors of these motivations can be classified in the following categories:

- First, *Market-related factors* (size of local market, growth of local market, access to regional market);

- Second, *Resource-related factors* (skilled labor, access to natural resources, access to capital market);

- Third, *Efficiency seeking* (cheap labor);

- Fourth, *Quality of business environment* (government effectiveness, incentives, stable investment environment);

- Fifth, *Other motivations* (follow the leader, others).

In the same time, there are eight major risk factors, as follows:

- Four risk factors considered „important“ or „very important“ by more than three quarters of the companies are: financial instability, global economic downturn, changes in investment regimes, and war and political instability,

- Another four risk factors considered „important“ or „very important“ by more than 60% of companies are: global terrorism threats, exchange rate fluctuation, perceived corruption and price volatility (petroleum, raw materials).

In fact, the essential question is how robust is the present world economic growth?

There is an optimistic point of view of the UNCTAD survey for period 2007-2009. But, various recent economic outlook reports confirm the existence of serious risks: the financial instability, the sharper slowdown in the United States, the oil prices and the geopolitical tensions.

3. Prospective world investments trends by host regions and countries

Regarding FDI prospects by host region, the UNCTAD survey points to three major findings:

- companies will increase their level of preference for South, East and South-

East Asia as well as for the new EU-12 countries as investment locations;

- Western Europe and North America will continue to be the leading destinations for investment flows;

- other regions, notably Africa and West Asia, will be given a lower degree of preference.

In addition, the survey shows a high concentration of TNCs in their respective home regions. For instance, companies from European countries are more present in other European countries than are other companies. Similarly, North American companies are better represented in North America (through cross-border investments between the United States and Canada) than their European and Asian counterparts.

In recent years, the regional distribution of inward FDI has been characterized by following trends:

- a rapid growth in FDI flows and stocks in the fast-growing economies in Asia; of the responding TNCs, 65% had already invested in South, East and South-East Asia in 2006;

- a percentage not far from that observed for the EU-15 and North America;

- the foreign investors presence in Africa, South-East Europe and the CIS and West Asia was considerably smaller, with less than 25%.

Ten most attractive countries for FDI by factors favoring investment, in the period 2007–2009 will be: China, India, United States, Russian Federation, Brazil, Viet Nam, United Kingdom, Australia, Mexico, Poland, and Germany.

FDI in the new EU-12, South-East Europe and the CIS are on the rise. Nearly half of the respondents had already invested there, and the region ranks fourth in the world as a preferred investment location for TNCs .

In the investors' views, the greatest locational assets of the region are growth of local markets, access to international markets (e.g. Western Europe), government effectiveness, access to skilled and cheap labour, size of local

markets and a stable investment environment.

Poland ranks tenth among the most attractive investment destinations worldwide, while Hungary, the Czech Republic, Romania and Bulgaria were also mentioned by some companies as attractive investment locations.

The Russian Federation is ranked fourth among the most preferred countries worldwide, while some respondents also mentioned Ukraine and Serbia as attractive locations.

Romania ranks the 39th place, in the preference list of investors, after Belgium.

4. FDI patterns by activities, home countries, modes of entry

The UNCTAD survey presents five major findings regarding the evolving patterns of FDI.

I. First, FDI is expected to grow rapidly in **a large number of activities**, such as those in the primary sector, intermediate goods manufacture, food processing, light manufacturing, trade and network services, a list which ranges well beyond the usually mentioned high-value-added manufacturing and service industries.

Concretely, the activities in the sectors are presented in Table 1.

Table 1. The sectoral FDI prospects

Sector	Activities
Primary sector	-The growing demand for raw materials and energy resources has prompted a new wave of FDI in extractive industries (oil and gas, metal minerals). - Expansion strategies of companies from emerging countries such as China are expected to play an important role in this trend.
Manufacturing sector	-Prospects for FDI are bright in most industries, including those considered the most traditional, due to a combination of factors. - There is the general trend towards the internationalization of companies, the setting up of larger scale international production and distribution networks, the existence of promising new products and activity segments in all industries.
Services sector	-This sector has been characterized in recent years by the rapid internationalization of companies which had lagged behind manufacturing companies in the 1970s and 1980s in terms of presence abroad. - The degree of internationalization of the top companies in services, other than financial services, is now close to that observed for the manufacturing sector.

Three major drivers are behind this trend:

- the desire of companies to gain access to local markets;
- the opening up of those markets to foreign investors through deregulation and privatization processes, including in infrastructure industries;
- increasing tradability of many services.

The most significant increases in FDI (by over 30%) are expected to occur in the trade (by 50%) and electricity, water and gas industries (by 40%).

There are the new activities connected with environmental and

energy concerns, which rank among the most powerful drivers of FDI for the coming years.

Major areas of future FDI involve the waste management, clean technologies and renewable energies. For example, in addition to economic concerns, the bloc's 27 governments (to the Spring European Council, Brussels, 13-14 March) are set to give further backing to an ambitious climate change commitment: to reduce the EU's CO2 emissions by 20% by 2020 while upping the bloc's use of renewable energy by 20% during the same period.

II. Second, the ongoing internationalization of corporate functions that were formerly concentrated in home countries, such as internal administrative services, decision making centers and researches and development (R&D), is expected to continue.

Production and distribution will remain the most internationalized functions, but presence abroad will increase in other business functions, such as administrative support centers, finance and regional headquarters.

Conceptually, it is about growing internationalization of corporate functions.

Many corporate functions (especially logistics, distribution, shared services and call centers) could be affected by a major re-engineering process, characterized by three main features:

- a growth in outsourcing, favoring the development of specialized business service providers;
- the implementation by companies of an integrated international network of support functions, relying upon specialized sites located in various countries;
- growing competition among potential host countries in attracting projects related to business services, which will provide companies with a larger range of location options, including the offshoring of some activities (e.g. support and call centers) to low-cost countries such as India or Morocco.

In R&D activities also, an increasing number of companies consider access to talent and innovation capabilities as a major aspect of competitiveness and seek to secure access throughout the world. In R&D activities, companies use several means to implement their global sourcing strategies, such as contracts with universities and research centers, investment of venture capital in promising projects, acquisition of start-up and innovative companies, acquisition of

patents and licenses, and setting up R&D centers abroad.

III. Third, the growing international ambitions of TNCs from developing countries (especially from Asia) could have an impact on the home-country pattern of FDI. With rapid development taking place in their home countries, these companies are increasingly becoming active international investors. Many TNCs from developing Asia mentioned that they intended to increase their investments abroad sharply (e.g. by more than 30%) over the period 2007–2009.

IV. Fourth, many companies are likely to expand their strategic scope beyond their home regions. The companies from European countries are more present in other European countries than are other companies. Similarly, North American companies are better represented in North America.

At the same time, FDI still prefers its home region, but its geographical scope is expected to expand. Consistently, the home region is always the one where the companies plan the largest increase in their investments abroad. But, regional expansion will thus remain a major driving force behind the international growth of companies.

V. Finally, the UNCTAD findings show that, while Greenfield projects will be the most commonly used mode of establishing operations into a specific host country, the propensity for M&As will be higher in developed countries, due to the existence of more takeover opportunities there than in the developing world.

In another hand, Greenfield projects will be mode to entry in the primary and manufacturing sector and M&As will be mode to entry in the services sector.

Per total, greenfield investments as entry modes into a specific country, by sector, 2007–2009 represent over 60%, while M&A represent under 40%.

5. Some issues related to FDI in the long term

Among the most frequently mentioned issues and uncertainties related to FDI and pointed out by the UNCTAD survey are the following: the environment, social responsibility, technological innovation, future of organization, demographic changes.

The environment. Beyond its foreseeable medium-term impact on projects in new energy or waste management, environmental concerns might have more widespread impacts on the geographical and sectorial structure of economies. For instance, growing negative externalities linked to „mega cities“ might lead to a growing attractiveness of medium-sized towns for investment projects. Moreover, the gradual exhaustion of oil resources might affect many activities directly based on them, such as those related to automobiles and transportation, basic chemicals and plastics, and even pharmaceuticals. All this will involve significant changes in sectoral investment patterns.

Social responsibility issues. Companies are increasingly facing various ethical and social issues connected with their activities abroad (e.g. the impact of their FDI activities on particular groups in the host and home economies, environmental issues and work ethics). Factors such as respect for social standards in host countries and a growing sense of eco-responsibility among companies involving a growing focus of investments on environment friendly processes may have an impact on FDI trends and structure.

Impact of technological innovation. The further development of information and communication technologies (ICTs) might have a major impact on the role of proximity in work organization, and thus on business networks and investment patterns. On the one hand, it could open up new fields for relocation of services, such as call centers or shared service centers, thus increasing

investment flows in these fields. On the other hand, it could also favor an increased reliance of companies on strategic alliances with remote partners, thus reducing the need to set up wholly-owned businesses in foreign countries.

The future of organizations. Corporations are affected by a series of internal transformation processes, which could have an impact on the way they are managed as well as on their international investment patterns. Among the most frequently raised issues relating to this are:

- the management of multicultural organizations, where participants are of diverse cultural origins and might differ in their specific values and ways of doing business;
- the notion of collaborative work and leveraging of knowledge, which can affect the way international innovation and R&D networks will be set up and managed;
- the management of risks and volatile markets, which could have consequences on the risk/profitability trade-off in the investment decision-making process.

Impact of demographic changes. The new important questions are the following: Will the ageing of populations in Western countries induce companies to locate in regions endowed with a younger population? Will advanced countries set up large-scale immigration policies aimed at attracting young qualified workers, thus developing new kinds of promotional activities in addition to those presently focused on FDI?

6. Possible effects of FDI on the Romanian economy

The Romanian Agency for Foreign Investments (ARIS) put foreign direct investments at 7 billion euros in 2008.

Continuing the trend of last year, ARIS expects a great share of FDI to come from significant Greenfield projects

developed especially in sectors with high value added, but also from expansions and development of investors already present in Romania.

The sectors forecasted to be the prime destination for investment this year refers to automotive and automotive component parts, construction materials, wood processing, pharmaceuticals, consumer goods, and also electronics.

Another field of activity with high potential for investment is the service sector, and especially IT and telecommunication, banking and insurance.

Renewable energy represents a quite new domain for Romania, but lately it registered a spectacular positive trend driven by the European directives in the field that support the extensive use of green energy.

Sectors like retailing and real estate that experienced a real boom in the recent years will continue to be among the top preferences of the foreign investors.

Foreign direct investments attracted by Romania in 2006 hit a record level of 9.05 billion euros or \$14.4 billions (BCR bank privatization is included), up 74% on the previous year.

Of this sum¹:

- 4.159 billion euros accounted for stakes held in companies (46% of the total FDI);

- 2.673 billion euros for reinvested net profit(30% of the total FDI);

- 2.227 billion euros for net loans secured from foreign investors (24% of the total FDI).

Net FDI inflows in 2006 amounted to EUR 34,512 million, and consisted of the following:

- The foreign direct investors equity stakes in the share capital of direct investment enterprises in Romania worth EUR 27,016 million (78% of net FDI);

- The reinvested net earnings that stood at EUR 7,496 million (22 percent of net flow).

At the end of 2006, the volume of foreign direct investments reached 34.5 billion euros, around one third of the gross domestic product(GDP), with the sums destined primarily to the manufacturing industry (34.2% of the total) followed by financial services and insurance (22.2%).

The FDI distribution by the 8 development regions in Romania offers information about the strong differences for the regional development, but from a profitability point of view, there is a FDI „congregation process“, because the foreign investors prefer a location which are already developed.

But, the value of foreign investments in Romania declined in the first 11 months of year 2007 by around 20% compared to 2006, to 6.6 billion euros². In the January - November period of 2006, the value of foreign capital stood at 8.3 billion euros.

As concerns the volume of FDI to be attracted in Romania for 2008, ARIS representatives consider FDI to reach EUR 7 billion, maintaining the level of inward investments in 2007- the first year of integration in the EU.

7. Conclusions

In the last years, Romania has become a more appealing target for an increasing number of foreign investors.

Romania offers to the foreign investors many major reasons to invest in Romania: great market potential, strategic location, significant natural resources, high skilled labor force, high potential for economic growth, new EU member, infrastructure growing steadily, friendly business environment, access to European funds, competitive taxation.

The UNCTAD Matrix of inward FDI performance and potential in 2005, consider that Romanian economy has a low potential FDI, but above performance

¹ BNR, FDI in Romania, as of 31 December 2006 (a survey on FDI).

² According to a statement made by Eugen Dijmarescu, vice-governor of the BNR (National Bank of Romania), Ziarul Financiar, 17 Ian. 2008.

FDI, comparing the judgement of the foreign investors.

But much remains to be done in the FDI field. Thus, the Foreign Investors Council (the FIC) from Romania believes that Romania must still improve the enforcement of new laws and regulations; tackle major social reforms, including reform of the labor market; increase its competitiveness and improve its infrastructure.

The efforts in order to ensure a stable and more transparent regulatory system must be increased. Moreover, the reform of the public administration must advance more quickly and judicial reforms must be implemented more effectively.

As well, the efforts to increase accountability must be intensified.

The environment is another major challenge the country continues to face. This includes air, water, and soil pollution; the non-efficient use of energy in domestic and industrial sectors.

As large-scale privatizations near completion, efforts must be made to attract more Greenfield foreign investment.

The success of such efforts will depend on Romania's ability to improve its investment climate and supply a skilled and competitive labor force within the tight framework of EU market rules.

REFERENCES

Mazerolle Fabrice	<i>Les Firmes Multinationales</i> , Ed. Vuibert, Paris, 2006.
CESifo	<i>World Economic Survey</i> , 6(2): 1-24 2/2007. Munich, Ifo Institute for Economic Research.
Romanian Agency for Foreign Investments	ARIS, site http://www.arisinvest.ro/level1.asp?id=198
National Bank of Romania	BNR, site http://www.bnro.ro
The Foreign Investors Council	<i>White Book</i> , FIC, April 2006, site http://www.fic.ro
UNCTAD	<i>World Investment Report 2006: FDI from Developing and Transition Economies: Implications for Development</i> . United Nations publication, New York and Geneva, 2006.
UNCTAD	<i>World Investment Report 2007: Transnational Corporations, Extractive Industries and development</i> . United Nations publication, New York and Geneva, 2007
UNCTAD	<i>World Investment Prospects Survey 2007–2009</i> , UNITED NATIONS, New York and Geneva, 2007
World Bank	<i>Global Development Finance 2007: The Globalization of Corporate Finance in Developing Countries</i> . Washington, DC., 2007
World Bank	<i>Global Economic Prospects 2007: Managing the Next Wave of Globalization</i> . Washington, DC., 2007.