

## THE EFFECTS OF FOREIGN INVESTMENTS ON ROMANIAN ECONOMY

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*The Romanian economy is marked by great micro and macroeconomic instability generated by the transition to a functional market economy. The direct foreign investments play an extremely important role among others in the formation of fixed capital necessary for the optimum operation in the framework of organizations, retechnologization and innovation by which the production costs are lowered and implicitly the improvement of their quality, the stability of balance of trade through the increase of exports, in attracting the workforce and also in the improvement of their professional skills. In the same time the FDI may have negative effects on the budget in the implementation stage owing to some tax facilities granted, to the rise of imports through the invested equipments but also the increase of unemployment by reorganization of private companies.*

*Keywords: Foreign investments, economic development, transnational corporations*

*Cod JEL lucrare: F 39*

### **The effects of foreign investments on Romanian economy**

In the context of the transition from a centralized system to a functional market economy based on competition, on the relation between supply and demand, an important role has the flow of foreign capital.

The effect caused by the foreign capital on the economy has two dimensions. On the one hand this plays a complementary role in the context of transition, as it supplements the limited financial resources of the country and reduces the effects generated by the unstrained state of economy, and on the other hand they have an important structural role in overcoming inefficiency and difficulties by using modern technological flows, managerial experience and economic administration.

By means of direct foreign investments it can be achieved:

- making of capital, as FDI contribute to a certain extent to the formation of fixed capital. Thus only the FDI flows out of which are subtracted FDI for the acquisition of production means already existing contribute to the formation of fixed capital that is new investments, reorganization investments, made in order to make some previous acquisitions profitable ( assets or corporate stock) and the rise of stock capital in the existing companies.

Therefore for estimating FDI which contribute to the formation of capital, the value of FDI made for acquisitions must be known.

- technological transfer and innovation activity. The specialists consider that one of the most important contribution of the direct foreign investments is represented by technology transfer, a special role in this way belonging to transnational societies. They can make the technology transfer either through internalization (transfer to branches) or externalization (franchise, licensing, technical assistance, etc). As compared to externalization, the technology internalization, by means of FDI is faster and cheaper, assuring in the same time the access to all technical assets, organizational company. The problem which arises is the way the access to technology is made as transnational offer already obsolete technology and if there are local capabilities to work with the new technology and to get profit.

The access to technology and advanced knowledge is more important than the invested amount and the technology import determines quite often a research activity for adapting them to the conditions of the host country. From technological perspective FDI determine the introduction of new technology which entails the manufacture and commercialization of a new product or price

reduction of an already made product, the introduction and development of new abilities of working with the new technology in the case of FDI which also imply the technology flows.

This advantage is very important for the host companies as these make use of depreciated and obsolete technology which may lead to the production of low quality goods having weak performances. Since direct investment presupposes the transfer of advanced technology, modern production techniques and know-how, the receiving company will register superior performances as regard productivity and products quality, which will determine the increase of their export competitiveness. Furthermore, the technology infusion may cause local undertaking effects by stimulating innovation in organizations, others than those in which the investment was made;

- the improvement of products quality which are competitive on the external market due to the fact that the Romanian products do not tally from qualitative point of view, not corresponding to the needs, requirements, changes on the wide world, many Romanian firms lost contracts with strategic partners;

- substantial price and production costs reduction, enlarging the external productivity of local producers and of exports;

- impact on competition, on resources, ownership relations and of economic policy. Sometimes the impact may also have a negative influence because transnational corporations use the superior market force to annihilate competition. That is why a series of laws as that of bankruptcy, competition, capital market have the role of avoiding such situations;

- influences on political, social, cultural field through a direct exposition of the economy of the host country to the political and economic system of other countries, attitude towards work, industrial relations and foreign workers, customs and behavior norms different from foreign societies;

- introduction of a new type of management in which the employees are directly interested in the good development of the organization which makes investments in the qualification and specialization of the staff and motivates them professionally and financially.

- attraction of redundant workforce because of reorganization of large companies, of bankruptcy of other societies or from the students attending schools. The impact of FDI on the workforce is influenced by great investors who generate new working places and pay higher wages than national companies, engaging young well-trained specialists, who contribute to the increase of labor productivity. The creation of new working places represents one of the positive effects generated by “greenfield” type investments. The number of new working places created by foreign investors represents the indicator of special importance for the governments of the receiving countries but considering the economic effects on a long term, it is more important the quality of the created working places than their number. The creation of working places which need qualified workforce presupposes transfer of knowledge and the permanent preoccupation for professional training, with favorable effects on the quality of human factor in the host country.

- the improvement of the level of workforce training when the foreign companies make investments in activities which presuppose a raised qualification of the employees, the foreign investors will pay an increased and permanent attention to the improvement of the staff of the organization receiving them. Furthermore, it may appear the phenomenon of knowledge diffusion acquired like that, if the employees of such companies direct to other sectors or start developing activities on their own.

- decentralization of activities and the development of market economy in which the competition is regarded as a positive factor of companies in attracting customers with quality goods at competitive prices;

- the use of external market segments proper to those who make investments, balancing imports with exports but also the commercial deficit.

-the increase of local firm efficiency and competitiveness that will be able to improve qualitatively the management level and that of production, and if they became the suppliers of foreign investors companies, they have access to new technologies or diversify their own production to face the competition caused by the presence of new economic agents on market.

- export promotion, the improvement of foreign trade structure. In a first stage of transnational expansion, the commercial balance of the host country might be negative because of the massive imports made by the branches- machines, equipments, raw materials, but once the export started, the balance also improves.

-decrease of the loan values to which Romania must resort to balance the budget deficit and the commercial one by adding to the GDP of the host county and by supplying supplementary income to the state budget by taxes and fees;

- the appreciation of the exchange rate and of payment balance. In case of FDI it must be made a comparison between the entrance flow of the project and the present value of the future income flows, using as an updating factor the rate of interest on the international market from which the respective country may borrow funds.

Usually the future flows updated are higher than the invested capital, because the rate of return in the developing countries is lower than the rate of interest on the international market accessible to these countries. Furthermore by means of FDI, currency is saved by substituting imports and also takes place the appreciation of the exchange rate.

- the support of privatization and restructuring process. In case of large public companies offered to be sold, when the local companies do not have enough funds for their acquisition and becoming profitable, FDI are the only solution. By privatization they benefit from financial flow, technology, know-how and from the quality of local workforce. Reorganization can be attained on three levels:

1. intersectorial restructure starting from the primary sector, passing from industry to services, the tendency being that of raising importance of the tertiary sector;

2. intrasectorial restructure from industries having a poor productivity, intensive in workforce, to intensive industries in knowledge and technology which register increase productivity.

3. company restructuring by utilizing a modern technology and by achieving some great value added activities;

- international economic integration, as it determines a better connection to international economy and an amplification of economic growth owing to a more efficient work division.

The role of foreign direct investments is to produce a sustainable development within the economy of the host country through the contributions brought to the increase of the level of work force engagement, of the standard of living and of GDP.

On the other hand the investments can generate negative effects which are sometimes inherent and generally become manifest on a short term, their appearance being closely related to the investment implementation or their becoming efficient:

- negative impact on the budget owed, on the one hand, to tax facilities given to foreign investors by the incentive policy, which has as an immediate effect the decrease of budgetary income. In the same time the increase of the number of the unemployed as a result of privatization and reorganization of public companies generate supplementary budget expenses, as the redundant workforce is not immediately absorbed by developing activities. On the long term, once the investments become mature, an increase of the state budget income can be registered owing to the taxes and fees paid by the newly set-up companies and their employees. It is to be noted that in the maturity stage of the investment, it is likely to appear unfavorable effects in case in which the transnational companies use specific mechanisms, especially that of transfer prices, with the aim to reduce the taxation burden by artificial decrease of fees and taxes owed to the host state budget.

- increase of imports, negatively reflected on the balance of trade is caused by the import of machines and equipments financed by the foreign investor, without which the implementation of the investment could not be possible. When the retechnologisation activity becomes evident in the growth of productivity and competitiveness, a decrease of the trade deficit can be registered especially when the foreign investor is export oriented or substitution of imports.

Negative effects on the payment balance appear when the foreign companies make loans abroad and then concentrate on a rapid recovery of the investment by using some techniques of tax evasion (transfer prices on high royalties).

- the increase of unemployment because of private companies reorganization with the aim of a rapid activity efficiency. A reduction of the working places in private companies can be registered but this disadvantage is insignificant in case in which the restructured companies benefit from the raise of efficiency and competitiveness, a situation in which, through training effects, may generate new working places through developing new activities which are in increase or decrease.

Beside there negative effects inherent on a short term, FDI may have a negative impact on a long term, especially in those countries which do not have a clear and coherent economic policy. For example, in an economy in which a number of transnational societies made investments it is unlikely that the optimum of each should coincide with the optimum of the host country economy, and, especially that the result of these decisions taken by societies from different domains should correspond to the optimum of aggregate of host country economy. In the lack of a clear economic policy even if all the players are reliable, the country in dispute may confront with economic unbalance owed to actions of foreign investors. When also the foreign investors held the monopol, in most cases they generate more negative social and economic effects than those registered in the situation of state monopol, but when the monopol position is competed by the existence of protectionist measures, then the negative effects on the social, economic level on the environment are amplified.

The direct foreign investment have become the most important external finance source for the world states, no matter the level of development, because unlike the bank borrowings and portfolio of investments are affected in a smaller extent by the financial crisis.

Romania's economy needs a substantial volume of foreign investments in order to balance economy and reduce the differences it has as compared to most European states.

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