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Foreign Direct Investments in Romania and the Impact of the EU Integration on Their Trend

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ABBREVIATIONS AND ACRONYMS

AVAS	= the Authority for State Asset Recovery
CEC	= Central European Countries
CEC-5	= The 5 Central European Countries-Czech Republic, Poland, Hungary, Slovakia, Slovenia
EBRD	= European Bank for Reconstruction and Development
G.D.	= Government Decision
EC	= European Commission
EFTA	= European Free Trade Association
IMF	= the International Monetary Fund
RG	= Romanian Government
SEEC's	= the South-Eastern European Countries
SEEC-8	= the South-Eastern European Countries – Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Moldova, Romania, Serbia and Montenegro
UNCTAD	= United Nations Conference on Trade and Development
USD	= United Sates Dollar
VAT	= Value Added Tax

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INTRODUCTION

The word "Globalization" and the expression "Let's bring the world together" are the buzz words of today world. This means that today it is very easy to communicate and travel everywhere in the world, transfer money to banks abroad, buy products on the internet or relocate and work for another branch of the same company located abroad. Technological progress, borders opening, trade liberalization and market integration are some of the major international phenomena accounting for these changes. They opened new ways for development and made it possible for countries to count not only on their national capabilities and domestic companies for economic growth but also on their neighbor countries or trade partners and on the financial potential of their firms, foreign direct investments (FDI) being a good example in this sense.

Even if it is a relatively new phenomenon[1], foreign direct investment, its determinants and its impacts have been closely analyzed. It is well known that the advantages for the country receiving FDI are multiple, including enhanced competition, productivity spillover, new employment opportunities and know-how transfer to domestic companies and the workforce. FDI became soon known world-wide mostly because of their significant benefits for the host country. Due to their growing importance and multi-folded advantages, countries became more interested in attracting foreign investors, causing a major challenge among the actors involved and influenced by the FDI effects like international trade organizations or the national governments but also among the scholars, economists or the great thinkers to find the main causes that determine companies invest in a foreign country and the criteria that help them choose a certain country for setting up their new business and thus theories for explaining the FDI causality appeared and many empirical analysis has been done.

[1] FDI started emerging at a larger scale after The Second World War but their flows became significant during the 1960's, see Jones J., Wren C., *Foreign Direct Investments and Regional Economy*(2006), p. 7, accessed at http://books.google.fr/books?id=yw_YUIGHg4IC&printsec=frontcover#PPA27,M1, on 07/04/09

The FDI flows are of particular interest to transition countries and good examples in this sense are the ex-communist countries in Central Eastern Europe. After 1989 they started the transition process from communism to capitalism, process that implied issues like market liberalization, democratization and building a proper business environment, aspects that were meant to help them catch up with the more developed countries from Western European.

Transition in CEECs has proved to be one of the most interesting periods of economic, social and structural change, helping countries that were formerly isolated from the international trade to eliminate trade barriers and be active within the process of integration into the global market and international organizations. Transition also means massive enterprise restructuring and infrastructure modernization. Domestic resources in these countries are limited and so FDI prove to be of great help and extremely valuable to them. In addition foreign investors bring capital flows that are non-debt-creating capital flows meaning that the host country can obtain more capital than its domestic potential without loans and debts. Due to this feature FDI are extremely important and the preferable method for financing the external current account deficit for countries lacking of capital flows such as the transition economies. As a consequence, attracting FDI has become an important item in the policy agenda of the governments of the transition countries and research in the field of FDI determinants has expanded rapidly.

As an ex-communist country, Romania matches perfectly the pattern described above. In 1990 it started the transition process and it was not only an economic transformation that Romania needed but also technological progress. An important role in achieving these goals was played by the foreign investors. Beside the economic benefits mentioned above, the foreign investors' arrival in Romania can also be seen as a good opportunity for domestic companies to catch up with the technological development. It was obvious that FDI became significant for the transformations and restructuring process needed in Romania and following the trend among the CEECs, the Romanian authorities started reforming the business environment in order to make it more attractive for the foreign investors.

One of the main targets during the transition process for Romania has been the EU integration. The EU accession negotiations have been a guide for the transition process in Romania, most of the transformations and reforms implemented having as targets the alignment to the EU standards. EU integration had thus a major impact and huge implications on the Romanian society on the whole and particularly on its economy and FDI inflows.

Having as starting point the facts presented above, the aim of this thesis was to find the determinants of the FDI flows received by Romania since 1990 when it started the transition process, to see if they match the pattern for the FDI determinants in the SEEC's, to discover if the EU integration was one of the main determinants of the FDI trend in Romania and if so, to find how the EU integration influenced the FDI flows received by Romania.

The first chapter has an introductive role and starts with presenting some theoretical concepts about FDI: definitions coming from two different authorities – the Organization for Economic Co-operation and Development (OECD) and the National Bank of Romania (NBR) - , FDI classifications in conformity with NBR and FDI components also in conformity with NBR standards. It continues with a brief presentation of the FDI theories and their statements about the FDI determinants.

To come closer to Romania's case, **the second chapter** tries to offer an overview on the FDI determinants in SEEC's. FDI theories give information about FDI determinants that can be universally accepted but the SEEC's have many particular features and in order to have a better view of their FDI determinants much empirical analysis has been done on the matter. The main findings of these empirical analyses are thus presented in this chapter in order to find the FDI determinants in SEEC's. The chapter describes also the integration theory about the evolution of the capital flows and empirical results about the effects of integration on the capital flows and their structure. It ends by concluding the main FDI determinants for the SEEC's assessed from the FDI theories presented in the first chapter, the empirical results, the integration theories and their corresponding empirical analyses.

The third chapter starts by presenting the EU integration as Romania's major challenge after 1990 and the main factor influencing the transition process in Romania. In this context, the major milestones in Romania's integration process offer proper information, explanations and insights into the reforms, their timing and effects and due to their importance they are emphasized at the beginning of the chapter. Further on, the third chapter offers an overview of the reform agenda applied in Romania including the privatization process, the reforming of the business environment and the evolution of the regulatory framework for FDI, and using the information presented, it concludes the main FDI determinants issued from the transformation process.

The fourth chapter starts with a short overview of the evolution of the FDI flows in Romania compared to the CEECs, SECs and the EU average and continues with a detailed analysis of the FDI trend in Romania during 1990 – 2007, related to the evolution of the macroeconomic indicators – GDP, GDP/capita, FDI % of GDP, etc - , trying to explain and find the determinants of the FDI flows evolution. The chapter continues with finding the main FDI determinants issued from the analysis and after it makes a brief comparison to the results offered by the FDI theories and the empirical evidence – the FDI determinants in the SEECs – and ends by concluding with the importance of the EU integration as an FDI determinant in Romania.

The period chosen for the analysis is 1990-2007 because it offers the possibility of analyzing the FDI flows during three periods that are important for the transition process of Romania: the first transformation years following the communist era (1990 - 2000), the years right before Romania's EU accession on the 1st of January 2007 (2001 - 2006) and during 2007, the year following the EU accession.

As a tool for the economic analysis in the fourth chapter, I will use the statistical – mathematical apparatus that will be applied to the economic indicators in order to explain the meaning of the numbers presented - shares, proportions, dynamics, etc. - , establish correlations and causalities between the economic indicators, explain these correlations and causalities, add commentaries and remarks.

For accuracy and objectivity, the information used for the economic analysis is provided by national organizations (the National Trade Register Office in Romania, the Romanian Authority for State Assets Recovery, the National Bank of Romania, the National Institute of Statistics) and also by international organizations (the International Monetary Fund, the United Nations Conference on Trade and Development, the Organization for Economic Cooperation and Development and EUROSTAT).

1. FDI – THEORETICAL CONSIDERATIONS

"Foreign direct investment (FDI) is the name given to a process where a firm from a country provides capital to an existing or newly – created firm in another country"[2]. Companies that locate their production in at least two different countries are usually referred to as multinational companies (MNCs). Due to the economic development and the technological revolution, foreign investors have spread all over the world, determining spectacular increases in the number of MNC's and in the level of FDI in the international economy that increased from 13 billion of USD in 1970 to 1,942 billion of USD in 2000[3]. This huge increase in absolute terms highlights the growing importance of the FDI to the global economy.

1.1. Definitions

The definitions below for the main concepts in the FDI field belong to two important organizations that are competent in the FDI domain: OECD - one of the organizations competent in the FDI field at international level - and NBR - one of the competent organizations in the FDI field at national level in Romania. Romania joined the "OECD Declaration on International Investment and Multinational Enterprises" on the 20th of April 2005, fact that means that Romania aligned its investment policy to the OECD standards and engaged itself to respect FDI framework within the OECD Guidelines for Multinational Enterprises[4]. As a consequence of this fact, the definitions presented bellow show that the NBR aligned its FDI policy and theoretical considerations to the OECD standards.

[2] Jones J., Wren C., *Foreign Direct Investments and Regional Economy*(2006), p. 7, accessed at http://books.google.fr/books?id=yw_YUIGHg4IC&printsec=frontcover#PPA7,M1, on 07/04/09
[3] data source: IMF, website www.imf.org, website visited 25/03/09
[4] http://www.oecd.org/document/53/0,2340,en_2649_201185_34749237_1_1_1_1,00.html, accessed on 16/02/09

- **Foreign direct investment**

The standard definition for FDI belongs to the Organization for Economic Co-operation and Development (OECD).

> "***Foreign direct investment*** *reflects the objective of obtaining a lasting interest by a resident entity in one economy (''direct investor'') in an entity resident in an economy other than that of the investor (''direct investment enterprise''). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise. Direct investment involves both the initial transaction between the two entities and all subsequent capital transactions between them and among affiliated enterprises, both incorporated and unincorporated*"[5].

The key aspect of this definition is that it presents the concept of FDI involving not only financial capital transfer but also a certain degree of control of one company in a country over another company in a different country.

This key aspect of the OECD definition for FDI can also be found in the FDI definition adopted by the National Bank of Romania (NBR)[6].

> ***"Foreign direct investment:*** *long-term investment relationship between a resident entity and a non-resident one; it usually involves a significant degree of influence from the investor on*

[5] OECD, *OECD Benchmark Definition of Foreign Direct Investments* (1996), pp. 7-8, accessed at http://www.oecd.org/dataoecd/10/16/2090148.pdf, on 16/03/09

[6] NBR, *Foreign Direct Investment (FDI) in Romania as of 31 December 2007* (2008), p. 1, accessed at http://www.bnro.ro/files/d/Statistica/seturi%20de%20date/FDI/eFDI2007.pdf, on 02/02/09

the management of the direct investment enterprise in which he/she invested.

Foreign direct investment is considered the following: paid-up capital and the reserves related to a non-resident investor owning at least 10 percent in the subscribed share capital of a resident enterprise, the loans between the investor and the direct investment enterprise as well as the reinvested earnings."

- **Foreign direct investor**

The OECD definition for this notion is:

> *"A foreign direct investor is an individual, an incorporated or unincorporated public or private enterprise, a government, a group of related individuals, or a group of related incorporated and/or unincorporated enterprises which has a direct investment enterprise – that is, a subsidiary, associate or branch – operating in a country other than the country or countries of residence of the foreign direct investor or investors."*[7]

The definition for this notion given by NBR is:

> *"Foreign direct investor**:** legal entity, private person or group of entities acting jointly and owning at least 10 percent of the subscribed share capital (or of endowment capital in case of*

[7] OECD, *op. cit.,* p. 8

*unincorporated entities) or at least 10 percent of voting power in an enterprise located outside the country of residenc*e."[8]

The main difference between the two definitions resides in the supplementary condition contained in the NBR definition, stating that a foreign company can be qualified as foreign direct investor if it owns at least 10% of the subscribed share capital or of the voting power in a company situated outside its residence country.

- **Direct investment enterprise**

The OECD definition for this notion is the following:

"OECD recommends that a direct investment enterprise be defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise."[9]

The definition offered by the NBR states that:

*"Direct investment enterprise***:** *an incorporated or unincorporated enterprise where a foreign investor owns at least 10 percent of the subscribed share capital or voting power, or the endowment capital in case of unincorporated entities (branches). A participation of at least 10 percent of subscribed share capital or voting power, or of endowment*

[8] NBR, *op. cit.,* p. 1
[9] OECD, *op. cit.,* p. 8

capital, is the prerequisite for the establishment of the direct investment relationship."[10]

Defining the *direct investment enterprise* concept, both OECD and NBR state the "10%" condition for the foreign direct investor, and thus OECD basing the *foreign direct investor* concept on the former, the difference mentioned above is eliminated.

1.2. FDI components

According to the NBR, the FDI have two components: the equity capital and the net credit.

According to NBR, **the equity capital "**includes subscribed and paid-up capital, both in cash and through in-kind contributions, held by non-residents in resident enterprises, as well as the related share in reserves; in case of branches, the available endowment capital shall be taken into account accordingly."[11]

As for the second FDI component, NBR states that the **net credi**t includes the borrowings of direct investment enterprise "from the foreign direct investor or from the group of non-resident companies that the former belongs to"[12]; the net credit doesn't include "the loans extended by the direct investment enterprise either to the foreign direct investor or to another entity within the group of companies"[13].

1.3. Types of FDI

The main FDI classification takes into consideration the contribution to the equity flow in the direct investment enterprises. According to this criterion, the NBR classifies the FDI in three categories as it follows:

[10] NBR, *op. cit.,* p. 1
[11] idem
[12] idem
[13] idem

- **Greenfield:** is defined as "the establishment of a new venture which is not based on a former domestic firm"[14]
- **Merger and acquisition:** represents the partial or the full takeover of domestic enterprises from residents by foreign investors;
- **Corporate development**: is defined as an increase in the capital of a direct investment enterprise by the foreign direct investor[15].

1.4. FDI Theory

The FDI theories appeared during the 1960's when the FDI started increasing in volume and new explanations were needed about the subject. Until then, there was no documentation about the FDI as they were treated like international capital inflows. The FDI theories had as purpose the explanation of the factors that influence the FDI flows, trying to find out "why foreign direct investment occurs, when it takes place and where it locates"[16].

The major FDI theory until the 1990's was *The Eclectic Paradigm (*also known as the *OLI framework)*, elaborated by John Dunnings[17], during the 1970's. According to his theory a company's decision to invest in a foreign country is determined by three major factors: ownership (O), location (L), internalization (I) and the company will decide to invest in a foreign country only if the three factors are fulfilled.

(O) – Ownership: means that the company has to have an ownership advantage that differentiates it from the other companies and that is hard to achieve by the competitors. The ownership advantage can be in a tangible form like a product or a fabrication process or in an intangible form like reputation or good management.

[14] Braunerhjelm P., Ekholm K., *The geography of multinational firms* (1998), p. 157, accessed at http://books.google.fr/books?id=Zo8ueiGsywcC&pg=PA157&dq=greenfield+investment#PPA157,M1, on 04/03/09
[15] NBR, *op. cit.,* p. 2
[16] Jones J., Wren C., *op. cit.,* p. 27
[17] Jones J., Wren C., *op. cit.,* pp. 27-28

(L) – Location : means that the foreign country chosen for the investment must offer certain location advantages that motivates the investor make the investment abroad rather than in his/her own country. Trade barriers, cheap workforce or easier access to clients can be seen as location advantages.

(I) – Internalization : means that the FDI will be considered more adequate if the company decides to internalize the ownership advantage by creating a new branch and not if the company decides to exploit its ownership advantage by concluding contracts or licensing[18].

Later on, Dunning added a new element to the previous three ones, saying that the FDI has to match in the long run strategy of the company.

As new challenges appeared causing major changes in the FDI flows, the OLI framework was not sufficient anymore to explain the FDI trends, such as the increasing volume of FDI between two rich countries in the context of the trade barriers falling[19]. Due to these inconveniencies, new models were conceived having as starting point the general equilibrium models[20] that was completed by the addition of the key variables from the OLI framework, ownership and location. Such a model was developed by J.R. Markuson and A.J. Venables[21]. The main feature of these new theoretical models is that they demonstrated and highlighted the importance of country specific features, such as economic development, in explaining the FDI trends and flows[22].

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[18] Jones J., Wren C., *op. cit.,* pp. 27-28

[19] Brenton P., Di Mauro F., Lucke M., *Economic Integration and FDI:An Empirical Analysis of Foreign Investment in the EU and in Central and Eastern Europe* (1998), Kiel Working Paper No. 890, Institut für Weltwirtschaft an der Universität Kiel, p. 6, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=139908, on 08/04/09

[20] the general equilibrium model comes from the general economic theory, a branch of economics that has as aim the explanation of the supply, demand and price behavior in an economy with several markets -

[21] Markusen J.R. , Venables A.J., *The Theory of Endowment, Intra-Industry and Multinational Trade* (1996), CEPR Discussion Paper N. 1341, abstract accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=4194, on 14/03/09

[22] Brenton P., Di Mauro F., Lucke M., *Economic Integration and FDI:An Empirical Analysis of Foreign Investment in the EU and in Central and Eastern Europe* (1998), Kiel Working Paper No. 890, Institut für Weltwirtschaft an der Universität Kiel, p. 6, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=139908, on 08/04/09

The International Trade Theory, conceived by the 2008 Nobel Prize for Economy winner, Paul Krugman[23], analyzes the impact of economies of scale on the international trade and it is associated to eliminating the customs barriers, policy that had as results the diminution of the production costs, and thus the possibility of locating a company where the production factors are less expensive, but also the possibility to use economies of scales in the production process and focus on the markets with easier entry access and that are bigger sized[24].

Generally, the FDI theories mentioned above talk about the important factors influencing the FDI flows, considering significant factors like location (an advantage that the investor has in a foreign country but not in his own), market size, trade barriers and the country's characteristics, such as economic growth.

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[23] http://nobelprize.org/nobel_prizes/economics/laureates/2008/, website visited 23/04/09

[24] Krugman, P. R., *Rethinking International Trade* (1994), accessed at http://books.google.fr/books?id=kR-5nhiJPV0C&printsec=frontcover#PPA16,M1, on 23/04/09

2. FDI DETERMINANTS IN SEEC'S

As new challenges appear every day determining major changes that need to be explained, the FDI theories proved to be insufficient and thus empirical analysis were done in order to find the explanations that were not provided by the theories. Due to its massive importance for both Western and Eastern European countries but mostly for the latter, the EU integration process and its impacts on capital flows, trade and FDI flows in the SEEC's has been an important subject for research and empirical analysis among the scholars and the international institutions. The simulations and empirical analysis had as basis the FDI theories and used different models, the most frequently used one being the gravitational model. It is used to explain bilateral flows of FDI at the empirical level and considers as very important factors the size of the market and less important ones the existence of good production factors[25].

2.1. Empirical Evidence

2.1.1. FDI Determinants in SEEC's

The main FDI determinants for the SEEC's issued from the empirical analysis are:

- **The macroeconomic indicators like GDP or GDP per capita of the host country**: they are relevant for the country's economic development and market potential, proving to be important determinants for the FDI flows. Certain studies on the CEEC[26] proved the existence of two opposite relations between each of the two

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[25] Serbu S. G., *op. cit.,* p. 16

[26] Brenton P., Di Mauro F., Lucke M., *Economic Integration and FDI:An Empirical Analysis of Foreign Investment in the EU and in Central and Eastern Europe* (1998), Kiel Working Paper No. 890, Institut für Weltwirtschaft an der Universität Kiel, p. 6, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=139908, on 08/04/09

macroeconomic indicators and the FDI: a positive relation between GDP and FDI but a negative one between GDP per capita and FDI, while other studies[27] showed the positive influence of both indicators on the FDI flows, the same positive correlation between the two macroeconomic indicators and the FDI flows being confirmed by some other empirical analysis[28]. Other important findings belonged to Bevan[29] that found through an empirical analysis that the GDP of the host country does not have a significant influence on the FDI flows but the existence of a great potential of exploitation of economies of scale does.

- **The distance between the country of the foreign investor and the country where the investment is made**: it is one of the elements influencing the transportation costs and most empirical analysis proved its significant influence on the FDI flows[30]. Still, there are studies that did not find its role as being significant, one of these studies having been done by Resmini[31]. Her empirical results showed as significant for the FDI flows factors like the salary differential translated by a low – cost workforce being more attractive for the foreign investors, followed by the market size of the host country, the degree of openness of the economy and also the stage of the transition process.

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[27] Gorg H., Greenaway D., *Is there a potential for increases in FDI for Central and Eastern European countries following EU accession?* (2002), Research Paper 2002/31, Leverhulme Centre, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410813, on 23/03/09

[28] Serbu S. G., *FDI flows towards CEECs: an analysis on the Romania, Hungary and Slovenia's performances*(2005), University of Orleans, France and "Babes-Bolyai" University, Cluj-Napoca, Romania, p. 11, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=873474, on 15/03/09

[29] Bevan Alan, Estrin Saul, *The Determinants of Foreign Direct Investment in Transition Economies* (2000), William Davidson Institute Working Paper 342, accessed at http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp342.pdf, on 24/04/09

[30] Serbu S. G., *op. cit.*, p. 19

[31] Resmini L., *The Determinants of Foreign Direct Investment into the CEECs: New Evidence from Sectoral Patterns*(1999), LICOS Discussion Paper no. 83/1999, pp. 22-25, accessed at http://www.econ.kuleuven.ac.be/licos/DP/DP1999/LICOSDP83.pdf, 25/03/09

- **The costs and the level of qualification of the labor force**: the correlation between the cost of the workforce and the FDI is not very significant and its importance varies from sector to sector – the FDI made in low-cost sectors are very sensitive to this issue while the ones in high-tech fields are less sensitive. This can be explained by the fact that the low cost workforce does not necessarily imply reduced production costs and this is mainly seen when the labor productivity is low[32]. The level of qualification of the workforce and its importance as an FDI determinant are appreciated differently in the empirical analysis: the working force is considered qualified in some studies if it has tertiary education[33] while for others secondary education is enough[34], both studies showing the significant aspect of the factor for the FDI flows.
- **The impact of the EU enlargement**: the empirical evidences showed that there is a correlation between the EU membership and the FDI flows towards the EU member states or EU candidate countries, such as: the EU member states are more likely to receive capital flows from other EU countries[35] and the official announcement of the EU concerning the perspectives of integration plays an important role in the configuration of the FDI flows[36]. Other important results were

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32 Serbu S.G., *op. cit*., p. 14

33 Gorg H., Greenaway D., *Is there a potential for increases in FDI for Central and Eastern European countries following EU accession?* (2002), Research Paper 2002/31, Leverhulme Centre, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410813, on 23/03/09

34 Carstensen K., Toubal F., *Foreign direct investment in Central and Eastern European countries: a dynamic panel analysis* (2004), *Journal of Comparative Economics 32 (2004)* p. 3-22, accessed at http://www.ifw-members.ifw-kiel.de/publications/foreign-direct-investment-in-central-and-eastern-european-countries-a-dynamic-panel-analysis/kap1143.pdf, on 23/04/09

35 Buch C.M., Piazolo D., *Capital and trade flows in Europe and the impact of enlargement (*Kiel Institute of World Economics : 2001*)*, p. 28, accessed at http://www.sciencedirect.com/science?_ob=ArticleURL&_udi=B6W8Y-44015W9-2&_user=7302445&_coverDate=09%2F30%2F2001&_rdoc=1&_fmt=full&_orig=search&_cdi=6667&_sort=d&_docanchor=&view=c&_acct=C000029858&_version=1&_urlVersion=0&_userid=7302445&md5=2d5b29b8cbf211b6567bbf19522adb49#bbib5, on 12/03/09

36 Serbu S. G., *op. cit*., p. 11

obtained by Gorg[37], that analyzed the potential for increased FDI following the EU integration process for some Eastern European Countries, identifying limited potential in the manufacturing sector and greater potential in the services sector. Brenton[38] obtained different results in his empirical analysis and they are focused on three main aspects. First, the FDI attracted by the CEEC had the expected level (corresponding to the GDP and GDP per capita values of the respective years) and the new potential investors should be stimulated by the host country of the FDI by the progress of the reform agenda and its economic growth, fact that shows the importance of the two factors. Second, the study found no proof that the FDI increase in the EU member states will cause a decrease in the FDI flows towards non-EU countries and third, the EU integration does not have a significant impact on the FDI stock of the new member states. Other important findings belong to Bevan[39]. He found that FDI flows to CEECs are mainly influenced by the unit labor cost, the market size of the host country, the country risk and the gravity factors. The key announcements made by the EC concerning the EU accession progress had a direct impact on the FDI trend towards the CEECs but did not affect the country credit ratings by lowering or increasing the country risk. An example in this sense is the EC's announcement about the Agenda 2000 that caused a bifurcation between the two announced waves, the FDI received by the first wave[40] adhering in 2004 rising

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[37] Gorg H., Greenaway D., *Is there a potential for increases in FDI for Central and Eastern European countries following EU accession?* (2002), Research Paper 2002/31, Leverhulme Centre, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410813, on 23/03/09

[38] Brenton P., Di Mauro F., Lucke M., *Economic Integration and FDI:An Empirical Analysis of Foreign Investment in the EU and in Central and Eastern Europe* (1998), Kiel Working Paper No. 890, Institut für Weltwirtschaft an der Universität Kiel, p. 6, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=139908, on 08/04/09

[39] Bevan A., *op. cit.*, pp. 26-27

[40] Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovakia and Slovenia as presented on the EC official website, http://ec.europa.eu/enlargement/the-policy/from-6-to-27-members/index_en.htm, website visited 23/02/09

steadily and being much more significant than the amount received by of the second wave countries[41] for the period 2000-2004. The country risk is mainly influenced by corruption, private sector development, government balance and industrial development.

Looking at the empirical results, the conclusion is that they had both contradictory findings and findings confirmed among themselves. Among the contradictions, for example the finding of Bevan[42] that the **GDP** of the host country is not significant for the country's FDI flows is exactly the opposite of the results found by Gorg and Greenaway[43] and Serbu[44]. This could be explained by the different years when the empirical analysis was done – Bevan (2000), Gorg and Greenaway (2002), Serbu (2005) – that caused three different periods for analysis and thus three different sets of data used, even if the countries that made the object of the study were the same, the CEECs. Another discrepancy between the empirical results concerns the significance found for **the distance between the host and the origin country of the FDI**. Serbu[45] found it significant for the foreign investors' decisions but Resmini[46] found the opposite. **The costs and the level of qualification of the labor force** were found important for the FDI flows by Gorg and Greenaway[47], Serbu[48] and Brenton[49]. The matching results about this factor's impact on the FDI trend in SEEC's account for its importance, making it thus one of the main factors attracting FDI to these countries. The **impact of EC's announcements concerning the EU integration** progress on the FDI distribution was found significant by Serbu[50] and Resmini[51] and

[41] Romania and Bulgaria, as presented on the EC official website, http://ec.europa.eu/enlargement/the-policy/from-6-to-27-members/index_en.htm, website visited 23/02/09
[42] Bevan Alan, Estrin Saul, *The Determinants of Foreign Direct Investment in Transition Economies* (2000), William Davidson Institute Working Paper 342, accessed at http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp342.pdf, on 24/04/09
[43] Gorg H., Greenaway D., *op. cit.* pp. 12-13
[44] Serbu S. G., *op. cit.,* pp. 11
[45] Serbu S. G., *op. cit.*, pp. 19
[46] Resmini L., *op. cit*, pp.22-24
[47] Gorg H., Greenaway D., *op. cit.*, pp. 12-13
[48] Serbu S. G., *op. cit.*, p. 14
[49] Brenton P., Di Mauro F., Lucke M., *op. cit.*, pp. 29-30
[50] Serbu S. G., *op. cit.*, p. 16
[51] Resmini L., *op. cit.*, pp. 23-25

further on, the work of Beven[52] and Resmini[53] concluded that the **transition process and the business environment** are of great importance for the FDI flows. Concerning the **impact of the EU integration** on the FDI trend following the accession process, some more findings were given by Buch[54]. He found that the EU member states are likely to receive more capital flows from other EU countries than from the non-EU members. The **EU integration process** can thus be seen as one of the FDI determinants in Europe, the empirical results offering information about the impact of the EC's announcements concerning the EU integration as an important FDI determinant and the FDI flows distribution and structure after the EU integration

2.1.2. FDI Determinants in SEEC's – Concluding the Empirical Evidence and the FDI Theories

Compared to the FDI theories, the empirical analysis found new particular determining factors for the FDI flows in SEEC's, such as **the impact of the EU enlargement** and **the distance between the host and the origin country of the FDI**, and confirmed the findings of the FDI theories, concerning the country specific features, such as the **economic development** stated by Markusen[55] and confirmed by the empirical results of Gorg and Greenaway[56] and Serbu[57] but adding new factors like **the stage of the transition process** (including factors like the private sector development, corruption, the country risk). Other common aspects of both theories and empirical results are the importance of economies of scale stated by Krugman[58] through his *International Trade Theory* and demonstrated by the empirical results of

[52] Bevan A, Estrin S, *op. cit.*, pp.26-27
[53] Resmini L., *op. cit.*, pp.23-24
[54] Buch C.M., Piazolo D., *op. cit.*, pp.28-29
[55] Markusen J.R. , Venables A.J., *The Theory of Endowment, Intra-Industry and Multinational Trade* (1996), CEPR Discussion Paper N. 1341
[56] Gorg H., Greenaway D., *op. cit.*
[57] Serbu S. G., *op. cit.,* p. 11
[58] Krugman, P. R., *Rethinking International Trade* (1994), accessed at http://books.google.fr/books?id=kR-5nhiJPV0C&printsec=frontcover#PPA16,M1, on 23/04/09

Bevan[59], **the costs and the level of qualification of the labor force in the FDI host country** that is specified in the *Eclectic Paradigm* of Dunnings[60] through the location element of the *OLI framework* – the low costs and the high level of qualification of the labor force in the FDI host country constitute an element that creates an advantage the investor has in the foreign country but not in his own – and confirmed by Serbu[61], Cartenesen[62] and Gorg and Greenaway[63], **the market size** of the host country, a consequence of Paul Krugman's[64] *International Trade Theory*, confirmed by the results of Laura Resmini[65] and Bevan[66] and not in the end the **trade openness.**

2.2. The EU integration - a Significant FDI Determinant for the CEECs

As shown by the empirical analysis for finding FDI major determinants, the integration of the SEECs into the international market and especially the EU integration proved to have a significant importance for their FDI flows. The most important effects coming from a country's integration within an international

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59 Bevan A, Estrin S, *The Determinants of Foreign Direct Investment in Transition Economies* (2000), William Davidson Institute Working Paper 342, accessed at http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp342.pdf, on 24/04/09
60 Jones J., Wren C., *Foreign Direct Investments and Regional Economy*(2006), p. 27-28, accessed at http://books.google.fr/books?id=yw_YUIGHg4IC&printsec=frontcover#PPA7,M1, on 07/04/09
61 Serbu S.G., *op. cit*., p. 14
62 Carstensen K., Toubal Farid, *Foreign direct investment in Central and Eastern European countries: a dynamic panel analysis* (2004), *Journal of Comparative Economics 32 (2004) 3-22*, accessed at http://www.ifw-members.ifw-kiel.de/publications/foreign-direct-investment-in-central-and-eastern-european-countries-a-dynamic-panel-analysis/kap1143.pdf, on 23/04/09
63 Gorg H., Greenaway D., *Is there a potential for increases in FDI for Central and Eastern European countries following EU accession?* (2002), Research Paper 2002/31, Leverhulme Centre, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410813, on 23/03/09
64 Krugman, P. R., *Rethinking International Trade* (1994), accessed at http://books.google.fr/books?id=kR-5nhiJPV0C&printsec=frontcover#PPA16,M1, on 23/04/09
65 Resmini L., *op. cit.*, pp. 22-25
66 Bevan Alan, Estrin Saul, *The Determinants of Foreign Direct Investment in Transition Economies* (2000), William Davidson Institute Working Paper 342, accessed at http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp342.pdf, on 24/04/09

structure that have direct impact on the FDI trend are the capital flows and the trade flows. The capital flows' effects are best explained by the integration theory.

2.2.1. The Integration Theory

In conformity with the *standard economic theory,* the integration of the under-developed or developing economies into the global market should be followed by capital flows coming from the developed countries to the former one, seen as poorer in terms of capitals, in order to equilibrate their balance of payments.

The *neoclassical theory* uses the law of marginal benefit (also known as the law of diminishing returns) to explain the flows of capital coming from the countries rich in capital to the poorer ones, stating that the capital flows towards the latter will stop when the capitals become consistent in its economy and the marginal returns on capital in the poor country will surpass the marginal returns in the richer country[67].

2.2.2. The Empirical Evidence

The fundament offered by the integration theory, still, lacked some explanations, such as the structure of the capital flows, and thus many empirical analyses have been done to find the needed information.

Razin *et al*[68] found through their analysis that after the integration process a country should receive high FDI flows and bank loans while at early stages of development and these will be replaced by portfolio investment as the country develops. These findings were confirmed by Hull and Tesar[69]. Other important

[67] Buch C.M., Piazolo D., *op. cit.*, p. 3.
[68] Razin, A., Sadka, E., Yuen, C.-W., *A pecking order of capital inflows and international tax principles* (1998) J. Int. Econ. 44, 45–68, accessed at http://www.sciencedirect.com/science?_ob=MImg&_imagekey=B6V6D-3VY50D7-3-2M&_cdi=5812&_user=7302445&_orig=na&_coverDate=02%2F01%2F1998&_sk=999559998&view=c&wchp=dGLbVzW-zSkWA&md5=b0877c3796c6efb76d7d1648a5abbf5e&ie=/sdarticle.pdf, on 04/05/09.
[69] Buch C.M., Piazolo D., *op. cit.*, p. 4

findings for the capital flows belonged to Lane and Milesi-Ferretti[70] that found the important elements for the external financial structure of a country as being trade openness, economic and financial development.

The empirical results confirmed the theories for integration stating that market and economic integration will have effects on both capital flows and trade development and brought further information about the capital flows' structure and the FDI flows as one of their components. The FDI flows are supposed to rise after integration, while the host country is still at early stages of development and then reduce and gradually be replaced by portfolio investments as the country develops.

2.3. FDI Determinants in SEEC's – Concluding the FDI Theories, the Empirical Evidence and the FDI Theories

Assessing the three positions presented, the main FDI determinants for the SEEC's can be sum up as it follows:

- **The economic growth (GDP, GDP per capita):** the factor is found important by the *FDI theories* through Markuson's[71] findings, by most of *the FDI empirical analysis* (Gorg and Greenaway[72], Serbu[73], Breton[74]) and not in the end by *the integration empirical analysis*

[70] Lane, T., Milesi-Ferretti, G.M., *External capital structure: theory and evidence* (2001), IMF Working Paper/00/152, accessed at http://www.imf.org/external/pubs/ft/wp/2000/wp00152.pdf, on 27/04/09

[71] Markusen J.R. , Venables A.J., The Theory of Endowment, Intra-Industry and Multinational Trade (1996), CEPR Discussion Paper N. 1341, abstract accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=4194, on 14/03/09

[72] Gorg H., Greenaway D., Is there a potential for increases in FDI for Central and Eastern European countries following EU accession? (2002), Research Paper 2002/31, Leverhulme Centre, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410813, on 23/03/09

[73] Serbu S. G., FDI flows towards CEECs: an analysis on the Romania, Hungary and Slovenia's performances(2005), University of Orleans, France and "Babes-Bolyai" University, Cluj-Napoca, Romania, p. 11, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=873474, on 15/03/09

[74] Brenton P., Di Mauro F., Lucke M., Economic Integration and FDI:An Empirical Analysis of Foreign Investment in the EU and in Central and Eastern Europe (1998), Kiel Working Paper No. 890,

through Lane and Milesi – Ferretti[75] that demonstrated the importance of the economic and financial development for the external capital flows.

- **The costs and the level of qualification of the workforce:** this aspect was considered important by *the FDI theories* through Dunnings[76] (the Location factor in his OLI framework refer to advantages the investor has in the foreign country but not in his own, the low-cost workforce being such an advantage) and Krugman[77] and also by most of *the empirical findings* (Bevan[78] and Resmini[79] that found important the low-cost workforce, Gorg and Greenaway[80] who's results showed the importance of the education and Serbu[81] that found the low-cost workforce significant for the FDI in the low-value sectors like manufacturing and insignificant in high-value sectors like services).
- **The EU enlargement:** it is a more particular element for Europe and mainly for the SEEC's. Due to this aspect and due to its relatively new importance, no *FDI theory* mentions this factor literally or makes reference to it. The *empirical analysis* found two main aspects connected to this factor as being significant for the FDI flows: the

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Institut für Weltwirtschaft an der Universität Kiel, p. 6, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=139908, on 08/04/09

[75] Lane, T., Milesi-Ferretti, G.M., External capital structure: theory and evidence (2001), IMF Working Paper/00/152, accessed at http://www.imf.org/external/pubs/ft/wp/2000/wp00152.pdf, on 27/04/09

[76] Jones J., Wren C., *Foreign Direct Investments and Regional Economy*(2006), p. 27-28, accessed at http://books.google.fr/books?id=yw_YUIGHg4IC&printsec=frontcover#PPA7,M1, on 07/04/09

[77] Krugman, P. R., *Rethinking International Trade* (1994), accessed at http://books.google.fr/books?id=kR-5nhiJPV0C&printsec=frontcover#PPA16,M1, on 23/04/09

[78] Bevan Alan, Estrin Saul, *The Determinants of Foreign Direct Investment in Transition Economies* (2000), William Davidson Institute Working Paper 342, accessed at http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp342.pdf, on 24/04/09

[79] Resmini Laur , The Determinants of Foreign Direct Investment into the CEECs: New Evidence from Sectoral Patterns(1999), LICOS Discussion Paper no. 83/1999, accessed at http://www.econ.kuleuven.ac.be/licos/DP/DP1999/LICOSDP83.pdf, 25/03/09

[80] Gorg H., Greenaway D., Is there a potential for increases in FDI for Central and Eastern European countries following EU accession? (2002), Research Paper 2002/31, Leverhulme Centre, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410813, on 23/03/09

[81] Serbu S. G., FDI flows towards CEECs: an analysis on the Romania, Hungary and Slovenia's performances(2005), University of Orleans, France and "Babes-Bolyai" University, Cluj-Napoca, Romania, p. 11, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=873474, on 15/03/09

official announcements about the enlargement made by the EC (Serbu[82] and Bevan[83]) and FDI trend after the EU integration (Gorg and Greenaway[84] found two different ways for the FDI behavior after the EU integration: the FDI in low-value sectors like manufacturing will tend to decline while the FDI in the high-value sectors like services will have an ascending trend; according to Buch and Piazolo[85], after the EU integration the new member states will receive more FDI flows from the EU countries comparing to non-EU countries; Brenton *et. al.* [86] found no significant impact of the EU integration on the FDI flows). *The integration theory* offers information about the capital flows going from developed countries to less developed ones. The empirical evidence offers more detailed information about the capital flows structure, the results obtained by Razin *et. al*[87]. suggesting that the capital flows after integration will be mainly composed of FDI and bank loans while the new integrated country is still at early stages of development and an increase in the share of the portfolio investments will occur as the country develops.

- **The transition stage and the business environment:** like the EU enlargement, it is a more particular element for Europe and mainly for

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[82] Serbu, S. G., *op. cit.*

[83] Bevan Alan, Estrin Saul, *The Determinants of Foreign Direct Investment in Transition Economies* (2000), William Davidson Institute Working Paper 342, accessed at http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp342.pdf, on 24/04/09

[84] Gorg H., Greenaway D., Is there a potential for increases in FDI for Central and Eastern European countries following EU accession? (2002), Research Paper 2002/31, Leverhulme Centre, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=410813, on 23/03/09

[85] Buch C.M., Piazolo D., *op. cit.*

[86] Brenton P., Di Mauro F., Lucke M., Economic Integration and FDI:An Empirical Analysis of Foreign Investment in the EU and in Central and Eastern Europe (1998), Kiel Working Paper No. 890, Institut für Weltwirtschaft an der Universität Kiel, p. 6, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=139908, on 08/04/09

[87] Razin, A., Sadka, E., Yuen, C.-W., *A pecking order of capital inflows and international tax principles* (1998) J. Int. Econ. 44, 45–68, accessed at http://www.sciencedirect.com/science?_ob=MImg&_imagekey=B6V6D-3VY50D7-3-2M&_cdi=5812&_user=7302445&_orig=na&_coverDate=02%2F01%2F1998&_sk=999559998&view=c&wchp=dGLbVzW-zSkWA&md5=b0877c3796c6efb76d7d1648a5abbf5e&ie=/sdarticle.pdf, on 04/05/09.

the SEEC's. Due to this aspect and due to its relatively new importance, no *FDI theory* mentions this factor literally or makes references to it. However, it is considered important for the FDI flows by *the FDI empirical evidence* found by Resmini[88] (the stage of transition is important for the FDI flows), Breton *et. al.* (the importance of the progress of the reform agenda), Bevan[89] (the country risk).

- **The market size:** it is considered important by both *FDI theories* and *empirical evidence.* Both theories of Krugman[90] and Dunnings[91] (it can be seen as an advantage that the investor has in the foreign country and not in his own country and though a component of the location element in the OLI framework) found the market size important. The empirical results were also favorable to this element, important being the positive findings of Rasmini[92] and Bevan[93].
- **Trade openness:** was found as an important FDI determinant by the FDI theories (Krugman[94] and the elimination of the trade barriers), *the FDI empirical results* through Resmini[95] and her findings that the degree of openness of the economy will positively influence the FDI

[88] Resmini L., The Determinants of Foreign Direct Investment into the CEECs: New Evidence from Sectoral Patterns(1999), LICOS Discussion Paper no. 83/1999, accessed at http://www.econ.kuleuven.ac.be/licos/DP/DP1999/LICOSDP83.pdf, 25/03/09
[89] Bevan Alan, Estrin Saul, The Determinants of Foreign Direct Investment in Transition Economies (2000), William Davidson Institute Working Paper 342, accessed at http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp342.pdf, on 24/04/09
[90] Krugman, P. R., *Rethinking International Trade* (1994), accessed at http://books.google.fr/books?id=kR-5nhiJPV0C&printsec=frontcover#PPA16,M1, on 23/04/09
[91] Jones J., Wren C., *op. cit.,* pp. 27-28
[92] Resmini L., The Determinants of Foreign Direct Investment into the CEECs: New Evidence from Sectoral Patterns(1999), LICOS Discussion Paper no. 83/1999, accessed at http://www.econ.kuleuven.ac.be/licos/DP/DP1999/LICOSDP83.pdf, 25/03/09
[93] Bevan Alan, Estrin Saul, The Determinants of Foreign Direct Investment in Transition Economies (2000), William Davidson Institute Working Paper 342, accessed at http://www.wdi.umich.edu/files/Publications/WorkingPapers/wp342.pdf, on 24/04/09
[94] Krugman, P. R., *Rethinking International Trade* (1994), accessed at http://books.google.fr/books?id=kR-5nhiJPV0C&printsec=frontcover#PPA16,M1, on 23/04/09
[95] Resmini L. , The Determinants of Foreign Direct Investment into the CEECs: New Evidence from Sectoral Patterns(1999), LICOS Discussion Paper no. 83/1999, accessed at http://www.econ.kuleuven.ac.be/licos/DP/DP1999/LICOSDP83.pdf, 25/03/09

flows and not in the end, by the *integration empirical analysis* with the help of the Lane and Milessi's[96] results that found trade openness as an important FDI determinant.

- **The distance between the host and the origin country of the FDI:** the factor was found important for the FDI flows in the SEEC's by the *empirical analysis* of Serbu[97]

[96] Lane, T., Milesi-Ferretti, G.M., *External capital structure: theory and evidence* (2001), IMF Working Paper/00/152, accessed at http://www.imf.org/external/pubs/ft/wp/2000/wp00152.pdf, on 27/04/09

[97] Serbu S.G., *op. cit*., p. 22

3. THE TRANSITION PROCESS AND THE EU CHALLENGE IN ROMANIA

Like all the ex-communist countries in Central-Eastern Europe, in 1990 Romania started the transition process. This meant the beginning of the long and very difficult way from communism and a central planned economy to liberalism and a market economy.

Stating as its aim the EU integration three years later, with the signing of *The Association Agreement with the EU,* Romania engaged itself in a transformation process to meet the requirements needed for the EU membership. In this context, the transition process and the reform agenda of Romania became closely linked to the EU integration process. The Romanian governments became focused on fulfilling the EU accession criteria formulated for the candidate countries coming from Central Eastern Europe during the European Council meeting in Copenhagen, in June 1993, and known as "the Copenhagen Criteria". The Copenhagen Criteria represent three compulsory requirements that the candidate countries have to fulfill for becoming EU members:

- The political criteria : stable institutions guaranteeing, democracy, the rule of law, human rights, respect and protection of minorities;
- The economic criteria : the existence of a functioning market economy and the capacity to cope with competitive pressure and market forces within the EU;
- The *acquis* criteria: the ability to assume the EU membership obligations by a candidate country, including the adherence to the aims of the political, economic and monetary Union[98].

[98] http://ec.europa.eu/enlargement/the-policy/conditions-for-enlargement/index_en.htm , website visited 28/04/09

3.1. Romania and the EU Challenge

As seen, the transformation process in Romania was closely related to the EU integration process and the reform agenda was mainly focused on fulfilling the requirements within the EU accession negotiation chapters. In this context, the major steps Romania made in the integration process offer proper information and important explanations and insights into the reforms, the decisions taken and their timing and effects.

3.1.1. Romania - Major Milestones in the Integration Process

Romania's relations with the European Community started back in the 60s, being the first country of Central – Eastern Europe to have official relations with it. In 1974 Romania became one of the countries included in the Community's Generalized System of Preferences.

After the fall of the communism Romania made clear its will to join the EU and since 1990 the EU integration became the main goal on the all the governments' agendas.

On the 1st of February 1993, Romania signed *The Association Agreement with the EU*, document that came into force two years later. Romania filed officially for the accession to the EU in June 1995 and in December 1999, the European Council decided the opening of accession negotiations with Romania, along with six other states. Officially, the negotiations were opened on the 15th of February 2000 and completed, at the technical level, in the Accession Conference at Ministerial Level on the 14th of December 2004, decision confirmed by the European Council in Brussels on the 16-17th of December of the same year. The Council also restated the timetable for Romania's EU accession as it follows: April 2005 - the signing of the Accession Treaty, the 1st of January 2007 - the actual accession.

The Accession Treaty of Romania and Bulgaria to the EU was signed on the 25^{th} of April 2005 in Luxembourg by Romania and Bulgaria on one side and the representatives of the Member States on the other side. Signature of the Accession Treaty was preceded by obtaining the opinion of the European Parliament, which was granted on the 13^{th} of April 2005, by an absolute majority of votes of parliamentarians Europeans.

Having been signed, the Accession Treaty has undergone the process of ratification in all EU Member States. Chronology of the ratification of the Accession Treaty: Slovakia (21 June 2005), Hungary (26 September 2005), Slovenia (29 September 2005), Republic of Cyprus (27 October 2005), the Hellenic Republic (2 November 2005), Estonia (16 November 2005) Czech Republic (6 December 2005), Spain (14 December 2005), Italy (22 December 2005), Malta (24 January 2006), Latvia (26 January 2006), UK (16 February 2006), Portugal (March 8 2006) , Lithuania (30 March 2006), Poland (30 March 2006), Sweden (9 May 2006), Austria (11 May 2006), Netherlands (13 June 2006), Finland (19 June 2006), Ireland (21 June 2006) Luxembourg (29 June 2006), France (3 October 2006), Belgium (13 October 2006), Denmark (21 November 2006) and Germany (24 November 2006).

After having signed the Accession Treaty, Romania has gone from the status of *candidate* to *state on the way to adhesion*, obtaining the quality of active observer to the EU's activities. Romania was, thus, associated both formally and practically to the work of all the Community institutions, at political and technical level (the EU Council and its sectoral formations, its working groups as well as the European Council meetings, the committees and working groups of the European Commission, the European Parliament, the Committee of the Regions and the Economic and Social Committee).

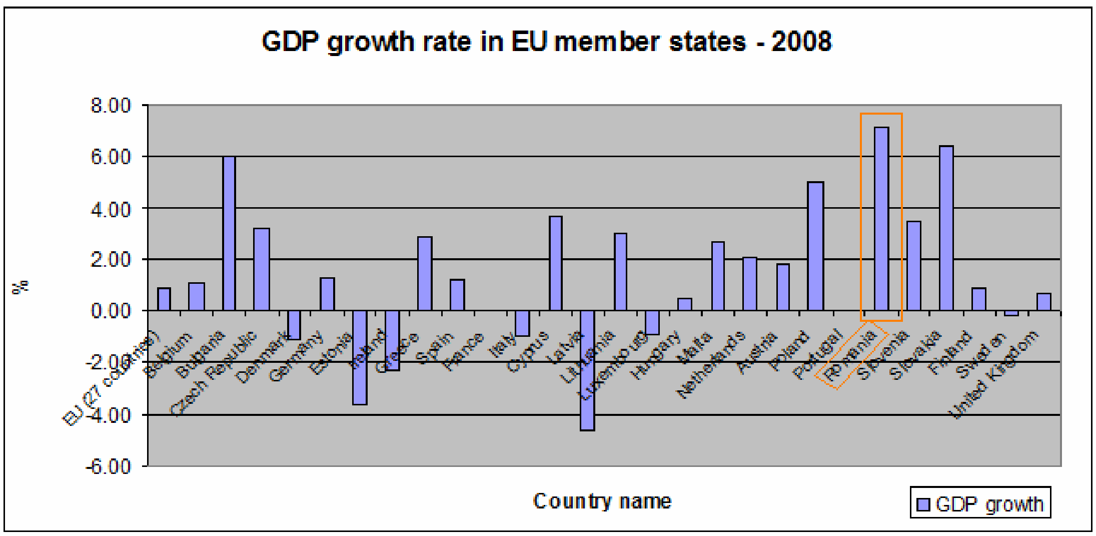
During 1998-2006, the European Commission presented the annual evaluation documents about Romania's way to EU, documents that were of two types: reports on the state of preparations for accession, and after signing the Accession Treaty, comprehensive monitoring reports that presented the progress towards the fulfillment of the commitments assumed by Romania in the Accession Treaty.

The EU Monitoring Report on the 26th of September 2006 confirmed Romania's accession to the EU and on the 1st of January 2007 the sixth enlargement of the EU to Romania and Bulgaria took place[99].

3.2. *The Reform Agenda and the Business Environment*

3.2.1. A Brief Overview

Figure 3.2.1.1. – The GDP growth rate in the EU member states, 2008



Source : author's compilation, based on the EUROSTAT statistics for 2008, http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/, web site visited 27/03/09

Having a GDP of 153487.4 million euros in 2008[100], Romania is a lower middle income country, with a surface of 237 500 km^2[101] - the 9th among EU member states – and a population of 21.5 million inhabitants[102] that makes it the second populated country in Central – Eastern Europe after Poland and the 7th in the EU. Despite its geographic and demographic advantages, the purchasing power per capita

[99] the website of the Romanian Ministry of Foreign Affairs, www.mae.ro, visited on 27/03/09
[100] EUROSTAT statistics, http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/, web site visited 27/03/09
[101] http://europa.eu/abc/european_countries/eu_members/romania/index_en.htm, website visited 05/05/09
[102] idem

is 60% lower than the EU27 average[103] making Romania one of the poorest countries in Europe but with a great potential for transformation and evolution, the GDP growth of 7.1% in 2008 being the highest among the EU member states.

The actual situation can be understood and motivated by the communist background of the country and its central planned economy but also by the poorly designed and slow moving reforms from the decade 1990 – 2000. In February 2001 Romania formally started the EU accession process[104] and thus it engaged itself in a more consistent macro-economic transformation process that included for starters the financial assistance and support of international organizations like the International Monetary Fund (IMF), the World Bank or the European Bank for Reconstruction and Development (EBRD)[105]. The results appeared soon in the GDP growth, the intense privatization policy, Romania holding the record for the most enterprises to be privatized of the Central European Countries in 2003[106], the adoption of a Fiscal Tax Code for the first time. Romania still had a lot to achieve and at the June 2004 Summit, the Council of the European Union reaffirmed "the Union's common objective to welcome Romania (and Bulgaria) as member states of the Union in January 2007"and confirmed "…its determination to bring the accession negotiations to a successful conclusion in 2004…", but on the condition that "real and effective progress in reforms and preparations on the ground for accession is maintained" and the two applicants "intensify their efforts in order to be ready for membership in 2007"[107]. During the following years Romania succeeded in complying with most of the EU requests still to accomplish and closed most of the EU accession negotiation chapters, the remaining issues that Romania is still being monitored for after its EU integration on the 1st of January 2007, being corruption and the judicial apparatus.

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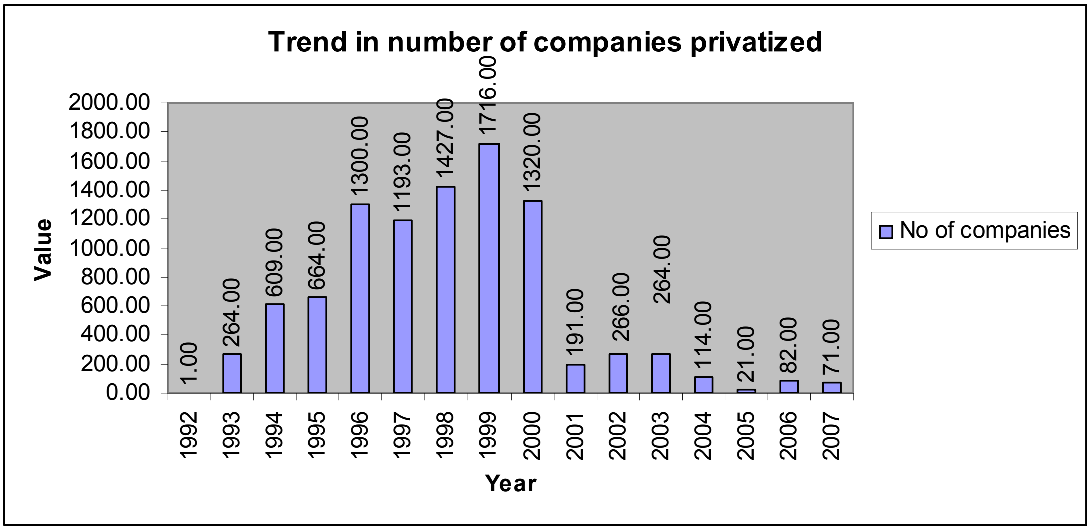
[103] EUROSTAT statistics for 2008, http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/, web site visited 27/03/09
[104] http://europa.eu/abc/history/index_en.htm, web site visited 08/05/09N
[105] http://194.102.208.22/def_en.htm, web site visited 08/05/09 (the old version of the National Bank of Romania's web site)
[106] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), p. 30.
[107] Brussels European Council, 17-18 June 2004, Presidency conclusions, Document 10679/04, p. 4-5, accessed at http://ue.eu.int/ueDocs/cms_Data/docs/pressData/en/ec/81035.pdf, on 09/03/09

3.2.2. Privatization

3.2.2.1. Major Steps

Figure 3.2.2.1.1 – Trend in number of companies privatized at the end of 2007



Source: author's compilation, based on data from AVAS (Romanian Authority for State Assets Recovery), www.avas.ro, web site visited 27/03/09

The main privatization methods used in Romania are:

- Mass privatization funds: mostly used in 1995-1996, lacked transparency towards population being managed mostly by the state.
- Management and employee buy-outs (MEBO): was predominant during 1993-1997 when a large number of inside owners and employees (almost 65% on average) bought shares in the Romanian companies with the help of the fixed – value grants offered by the Romanian state.
- Direct sales or sale for cash: were predominant during the period 1996-1998 and they contributed to a jump of both the number of privatized companies, as seen in Figure 4.2. and the FDI received by Romania.

- Sales to strategic investors: dominated the privatization process starting with 1998 but involved large state-owned companies only after 2001. An important issue was then for the first time not only the number of companies sold but also the share of the capital transferred to the private sector that meant the lowering of the role played by the state in the national economy.

Table 3.2.2.1.1. – Trend in the number of privatization contracts, privatized capital and privatized capital to foreign investors in Romania, 1993-2007

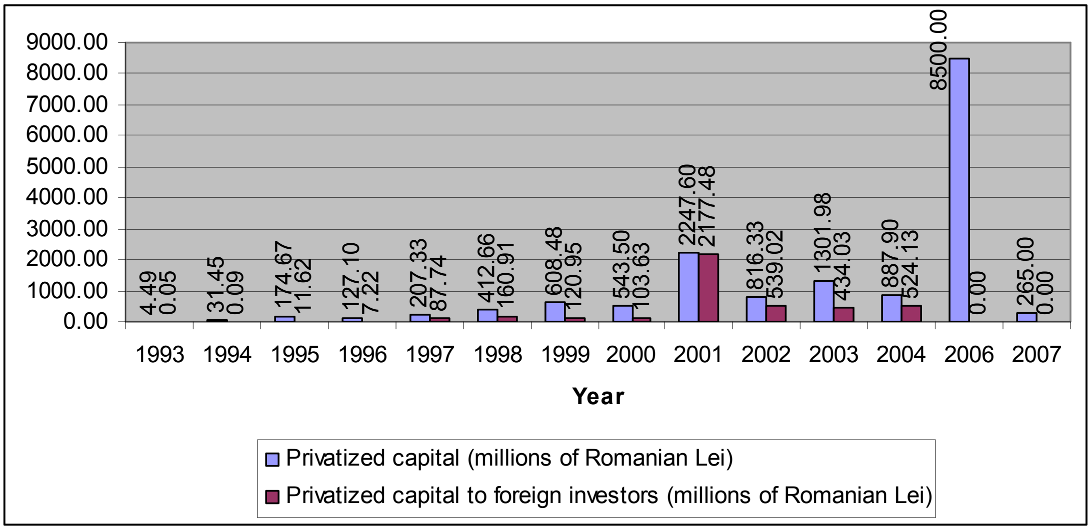
Privatization year	Number of privatization contracts	Privatized capital (millions of Romanian Lei)	Privatized capital to foreign investors (millions of Romanian Lei)
1992	1.00		
1993	264.00	4.49	0.05
1994	609.00	31.45	0.09
1995	664.00	174.67	11.62
1996	1300.00	127.10	7.22
1997	1193.00	207.33	87.74
1998	1427.00	412.66	160.91
1999	1716.00	608.48	120.95
2000	1320.00	543.50	103.63
2001	191.00	2247.60	2177.48
2002	266.00	816.33	539.02
2003	264.00	1301.98	434.03
2004	114.00	887.90	524.13
2005	21.00	..	..
2006	82.00	8500.00	..
2007	71.00	265.00	..
TOTAL	9503.00		

Source: AVAS Romania (Romanian Authority for State Assets Recovery)

Note: the data for the series "Privatized capital to foreign investors" is missing for the years 2006 and 2007, and no data is available for 2005

Privatization in Romania can be catalogued as slowly and still ongoing, compared to the most successful privatization processes in transition countries. The first important privatization year was 1992 when the privatization acts started with the small scale privatization, generating at the same time the first significant foreign direct investments to Romania[108]. However, the privatization process started properly in 1998 when the legal framework[109] was created and by the end of 2003, only 40% of the large enterprise and about 66% of the medium-sized enterprises had been privatized[110].

Figure 3.2.2.1.2. – Trend in privatized capital and privatized capital to foreign investors in Romania, 1993-2007



Source: AVAS Romania (Romanian Authority for State Assets Recovery)

Note: the data for the series "Privatized capital to foreign investors" is missing for the years 2006 and 2007, and no data is available for 2005

As seen from the Table 5.3.2.1., the most successful period for privatization in Romania was 2001-2004, when the capital sold represents over half of the total capital sold until 2004. This period is also the beginning of an increase in the foreign investors' involvement in the privatization process, the amount of capital bought by the foreign investors being 5.4 times higher than the amount bought during 1992 – 2000 and representing around 84% of the share capital sold by the Romanian state in the privatization process since 1992. This type of FDI, determined by the

[108] Serbu S. G., *FDI flows towards CEECs: an analysis on the Romania, Hungary and Slovenia's performances*(2005), p. 8, University of Orleans, France and "Babes-Bolyai" University, Cluj-Napoca, Romania, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=873474, on 15/03/09

[109] see next subchapter : 5.3.3. – "Administrative and Non-discriminatory Barriers"

[110] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), p. 32.

privatization process is often referred to as privatization-related FDI and it had its peak in 2001, when 96.90% of the state-owned enterprises were privatized to foreign investors.

Most of the successful privatization stories happened during 2001-2004 and they include:

- SIDEX – the largest steelmaker that was privatized to the Indian – British LNM Holding in 2001;
- Electrica Oltenia and Electrica Moldova – the electricity distributor that covered around 20% of the electricity market was sold to the Italian company Enel in 2004 for 112 million euro;
- Petrom – the largest state-owned company and the national gas distributor was sold in 2004 to the Austrian group OMV, for 1.6 billion USD.

The intense privatization process driven by the Romanian government during 2001-2004 is closely linked to the fact that 2001-2004 was Romania's official period for EU accession negotiations.

The privatization process continued successfully during the following years and 2006 proved to be the most significant, with privatized capitals that almost equaled the total amount of sold capital since 1990. 2006 being the year preceding Romania's entering the EU, this intense privatization can be explained by Romania's need to accomplish its EU engagements.

The major privatization deals concluded were:

- The privatization of "Electrica Muntenia Sud", the major electricity supplier in the Southern part of Romania, to the Italian company Enel, in 2006[111];
- The privatization of the CEC Bank (Romanian Savings Bank) to the National Bank of Greece in 2007[112].

[111] AVAS, www.avas.ro, website visited 03/04/09
[112] idem

The total number of companies privatized at the end of 2007 was 9503, number that does not include the privatization contracts that were cancelled due to not fulfilling the requirements and not implementing the causes stipulated in the sale-purchase contract during the post privatization monitoring period.

3.2.2.2. Benefits and Follow-ups

At the end of 2007 the privatization process was mainly over[113]. Its benefits for the Romanian economy were multiple.

- **The privatization-related FDI**

The successful privatization stories sustained by the IMF, EBRD and required by the transformation process for the EU accession had a very positive effect on the FDI received by Romania on the long run, 204 of the largest foreign companies that came to Romania still being important players on the national market.[114] The privatization process opened and stimulated the foreign investors' arrival in Romania, increasing significantly the privatization-related FDI, which dominated the FDI flows in Romania before the EU accession in 2007, mainly during the negotiations period 2000-2004 and in the pre-accession year 2006[115].

- **The increase of private sector share in the economy**

Another important aspect of the privatization process was its contribution to establishing a functioning market economy, which is part of the economic criteria the candidate countries have to fulfill in order to become EU members. Through

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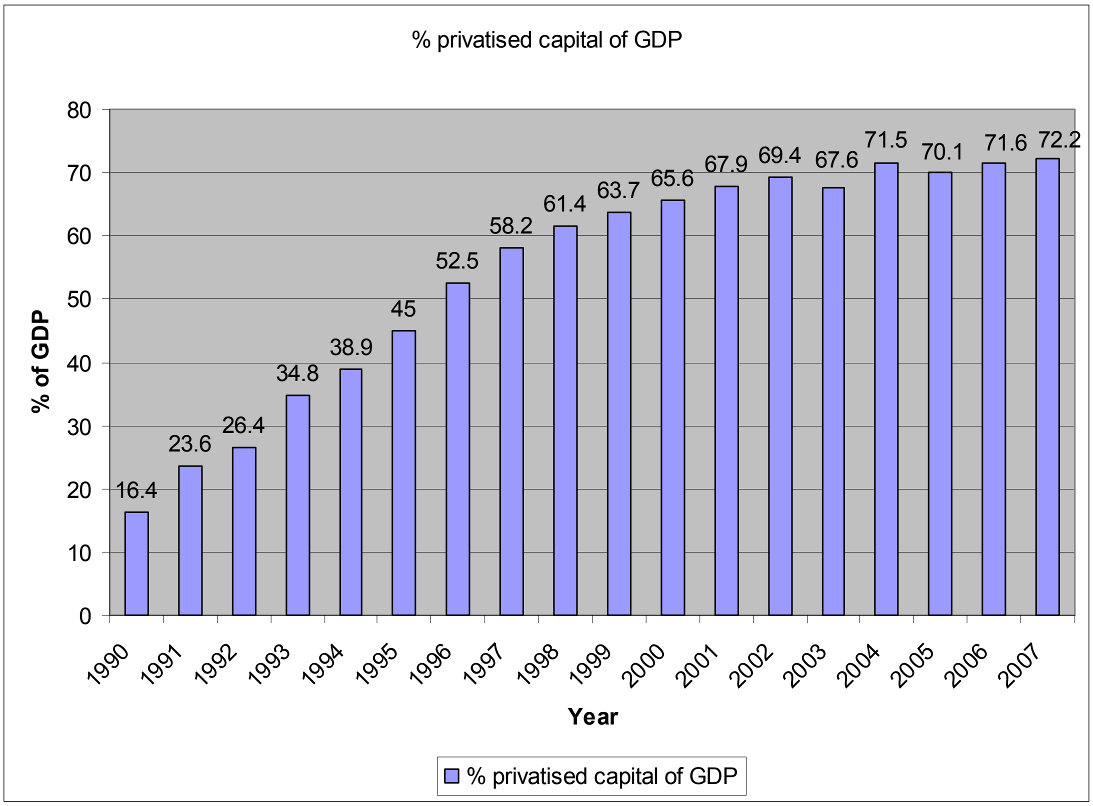
[113] idem
[114] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), pp. 30-34.
[115] data in Figure 5.3.2.2., AVAS website www.avas.ro, visited 03/04/09 and European Commission's Directorate General for Economic and Financial Affairs, *FDI in Romania: from low-wage competition to higher value-added sectors* (2008),p. 2, accessed at http://ec.europa.eu/economy_finance/publications/publication11881_en.pdf

privatization the major state-owned companies become the property of private investors, the first major step in passing from a central-planned economy to a market economy based on concurrency and private ownership.

Figure 3.2.2.2.1. – The privatized capital as % of GDP in Romania, 1990-2007



Source: The Statistical Yearbook of Romania – editions 1990, 1996, 2000, 2003 and 2008

The degree of involvement by the state-owned companies in the economy has considerably diminished since the privatization process started, the private companies' importance within the national economy growing constantly. If in 1990 the private companies accounted for only 16.4% of GDP, in 1996 the private sector managed to surpass for the first time the state-owned companies in terms of GDP contribution and in 2007, 72% of all final goods and services produced in Romania came from private companies.

3.2.3. Business Environment

One of the main tasks the Romanian governments have been confronted to during the transition process and one of the major issues of all the transition economies is the reforming of the administrative apparatus, voting and putting into practice new regulations and laws to change the business environment and make it proper for both the domestic and foreign investors. For Romania, this process is also connected to completing of the EU agenda.

- **Administrative barriers**

As privatization has been one of the major issues during the transition process and the first step towards a market economy, most of the efforts of the Romanian governments were focused since 2001 on identifying and reducing the barriers faced by the private investors when starting and conducting a business, implementing a more transparent policy framework for private investors and having better communication channels with the business community. In order to achieve these goals Romania asked for the help of international institutions like *OECD South-East Europe Compact for Reform, Investment, Integrity and Growth* and created new units within its ministries like the *Business Environment Unit* created within the *Ministry for the Economy and Commerce* with the special purpose of closely implementing and monitoring action plans for the regulatory reform[116].

The main outcomes were:

- *Law on Transparency in Public Administration* No. 52/2003 stating that the public institutions have to have prior consultation with the interested parties when making legislation;
- *Legislation on the Tact Silent Approval Procedure* from November 2003 that permits companies to take action if they received no answer within 30 days from the appropriate government authority;

[116] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), pp. 40-43

- *Bankruptcy Law and Judicial Reorganization Law* No. 149/11.05.2004 improving the rights of the creditors and making it easy to end up un unprofitable business;
- G.D. No. 396/2002 deciding that any new law should come with an assessment of the regulatory impact being in line with the OECD standards;
- The approval of the "*Strategy for the Development of SMEs for the period 2004-2008*";
- G.D. No 913/2004 and G.D. No. 991/2004 that introduced the on-line possibility of registering a new business on the website of the National Trade Register Office – the official institution for registering new businesses in Romania, thus facilitating the formalities for starting up a new company[117];

The measures taken by the Romanian authorities in improving the business environment have been going in the right direction, progress stated by the Monitoring Report released by the European Commission in September 2006[118]. They made easier both the process of setting up a new business by completing an on-line application and submitting it on the website of the National Trade Register Office and the process of conducting a business by helping the SME's and involving the private companies in the decision making process if it concerns their interests.

- **Taxation**

The Fiscal Code from the 1st of January 2004 brought together for the first time all the laws and regulations on taxes and is considered to be one of the main steps taken by the Romanian authorities in improving the business environment.

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[117] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), pp. 40-43 and the Romanian Ministry of Public Finance, website http://www.mfinante.ro/engl/index.jsp, visited 07/05/09.

[118] the European Commission, *Monitoring Report on the state of preparedness for EU membership of Bulgaria and Romania* (2006), p. 6 , consulted on http://ec.europa.eu/enlargement/pdf/key_documents/2006/sept/report_bg_ro_2006_en.pdf, website visited 25/05/09

In order to be in line with the EU requirements, a new Fiscal Code was adopted and came into force on the 1st of January 2007, stating the values for the VAT that remains 19% and the single flat tax rate that stays at 16%, which means that both individual and corporate incomes are taxed with a single tax rate of 16%, being known as the *single tax reform*. It was followed by the Emergency Government Ordinance No. 91/2008 that meant bringing into the Romanian fiscal code the latest changes from the EU legislation and align it to the EU trend[119].

Taxation through the *single tax reform* made Romania one of the most competitive countries in the region for the foreign investors, due to the low level of the tax rate comparing to the neighbor countries.

Figure 3.2.3.1. – Some of the countries that adopted the *flat tax regime* in Central and Eastern Europe, 2008

Some countries that adopted flat tax regimes

Country	Rate (%)	Year of enactment
Albania	10	2008
Bulgaria	10	2008
Czech Republic	15	2008
Estonia	21	2008
Latvia	25	1995
Lithuania	24	2008
Macedonia	10	2008
Romania	**16**	**2005**
Russia	13	2001
Slovakia	19	2004
Slovenia	21	2008

Source: Larive Romania International, *Foreign Direct Investments in Romania*, pp. 1-2, accessed at http://rbd.doingbusiness.ro/en/2009/april/romanian-business-climate/2/149-foreign-direct-investment-in-romania.html, the Romanian version of the website www.doingbusiness.org, belonging to the World Bank, on 02/02/09

[119] Romanian Ministry of Public Finance, http://www.mfinante.ro/engl/link.jsp?body=/engl/cod_fiscal/cuprins.htm, website visited 25/05/09

- **The judiciary and corruption**

A functioning market economy can't exist without the rule of law and without an independent judiciary system guaranteeing the equality before the law and the effective implementation of the law. Corruption is also an important obstacle against a better business climate and an impediment for both domestic and foreign investors. Even though many laws and reforms have been implemented by the Romanian government to prevent corruption (Law No. 301/28.06.2004 on a New Criminal Code, setting a "special bribery hotline" in the Office of the Prime Minister[120]) and help the judiciary system (a comprehensive Judicial Reform Strategy for 2003-2004 on the implementation of fundamental principles of justice and the functioning of judicial institutions and magistrates[121]), the EC concluded in the Monitoring Report from June 2006 that Romania still hasn't completely resolved the two issues and thus it is still being monitored, even after its EU integration in 2007[122].

3.2.4. The Framework for FDI

3.2.4.1. The Legal and Regulatory Framework for FDI

In order to make the business climate more attractive and attract foreign investors to Romania, the Romanian authorities created new governmental bodies and adopted new investment laws and reforms.

In 2002, the Romanian government voted the Law No 390/2002 that decided the creation of the Romanian Agency for Foreign Investment (ARIS) within the

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[120] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), pp. 44-45.
[121] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), pp. 43-44.
[122] European Commission, *Monitoring Report on the state of preparedness for EU membership of Bulgaria and Romania* (2006), pp. 5-6 and 9-10, consulted on http://ec.europa.eu/enlargement/pdf/key_documents/2006/sept/report_bg_ro_2006_en.pdf, website visited 25/05/09

Romanian government, its main aim being providing consultancy to the foreign investors[123].

The most important pieces of legislation adopted by the Romanian government, apart from the Fiscal Code, are the following:

- Commercial Code
- Company Law
- Competition Law
- Law on Direct Investment (The Emergency Government Ordinance 85/2008 on stimulation of investments)
- Law regarding the promotion of direct investments
- Law on Banking Activities
- Securities Law
- Commercial Companies Privatization Law
- Trade Register Law [124]

The Emergency Government Ordinance 85/2008 on stimulation of investments known as the "Law on Direct Investment" is the most important and it settles the framework for investments respecting the latest trends in the EU's legislation for investors. It is of particular interest for focusing on the development regions that are less developed and received less investments in the past, trying to lower the inter-regional disparities and assure a balanced territorial development.

National treatment for foreign investors (defined by the OECD National Treatment Instrument as "treatment no less favorable than that accorded to domestic enterprises"[125]) is the major principle at the basis of the functioning of foreign companies on the Romanian territory. In practical terms, this means that foreign investors have no restrictions in choosing the investment field or the legal form of

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[123] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), pp. 40-43.
[124] Price Waterhouse Coopers, *Guide to Doing Business and Investing in Romania* (2007), p. 20, accessed at *www.pwc.com/ro/eng/ins-sol/publ/2006/pwc_b**guide**2007.pdf*, on 25/02/09 and ARIS's website www.arisinvest.ro , visited 08/04/09
[125] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), p. 51.

their company compared to the domestic investors, having the same benefits and obeying to the same set of laws as the domestic ones[126].

The efforts made by the Romanian authorities to improve the FDI framework were noticeable and they contributed significantly to Romania becoming a more welcoming host for the foreign investors. A special governmental body, ARIS, dedicated exclusively to foreign investors was created and the treatment for foreign investors' inside Romania is the same as for the domestic investors, the so called "national treatment".

3.2.4.2. International Commitments and Agreements for FDI

Romania is an EU member and had to make its FDI regulatory framework conform to the EU laws. It is also a member of WTO and has free trade agreements with the EFTA and CEFTA countries, Israel, Turkey and a number of SEEC. Romania has also signed Bilateral Agreements on the Promotion and Reciprocal Protection of Investments with 83 states[127].

Still, one of the most important agreements of Romania concerning FDI was the signing of the "OECD Declaration on International Investment and Multinational Enterprises" on the 20th of April 2005, fact that means that Romania aligned its investment policy to the OECD standards and engaged itself to respect FDI framework within the OECD Guidelines for Multinational Enterprises[128].

Romania's participation in international agreements and commitments shows its ability and willingness to adapt to the internationally accepted regulation and represents an acceptation and recognition of the reforms implemented on its territory. The alignment with the internationally accepted regulation for FDI can be seen as a strong incentive for attracting foreign investors that have to obey in Romania the same FDI laws as in most developed countries or even in their own country.

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[126] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), p. 51.
[127] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), pp. 72-75.
[128] http://www.oecd.org/document/53/0,2340,en_2649_201185_34749237_1_1_1_1,00.html, accessed on 16/02/09

3.2.5. Conclusions

All the three processes presented – privatization, transformation of the business environment and evolution of the FDI framework – proved to be successful and had very important consequences for the foreign investors.

- **Privatization**

The privatization process opened and stimulated the foreign investors' arrival in Romania, increasing significantly the privatization-related FDI, which dominated the FDI flows in Romania before the EU accession in 2007, mainly during the negotiations period 2000-2004 and in the pre-accession year 2006 [129]; it also contributed to the a significant increase of the private sector share within the national economy.

- **Business Environment**

The reforming of the business environment was done by eliminating most of the bureaucratic and *administrative barriers* in setting and conducting businesses, by implementing a proper and competitive *taxation* program and by trying to reform the judicial system and solve the corruption problem, the last two issues remaining still unresolved. The reforms managed to fix many existing issues and literally made the domestic and foreign investors' work easier, but the remaining aspects as corruption and the judicial reform have a big negative impact on both the existing and the potential investors, mainly the foreign investors that are not familiar with the Romanian business environment.

[129] data in Figure 5.3.2.2., AVAS website www.avas.ro, visited 03/04/09 and European Commission's Directorate General for Economic and Financial Affairs, *FDI in Romania: from low-wage competition to higher value-added sectors* (2008),p. 2, accessed at http://ec.europa.eu/economy_finance/publications/publication11881_en.pdf

- **The Framework for FDI**

The efforts at national level included the creation of a special governmental body, ARIS, dedicated exclusively to foreign investors and the adoption of the so called “national treatment” for foreign investors, meaning that their treatment within Romania is the same with the domestic investors’ treatment. At international level, Romania signed agreements and commitments and thus it aligned itself with the internationally accepted regulation for FDI, showing *trade and economic openness*. Both national and international efforts made by Romania managed to ease the foreign investors way into the Romania economy and proved Romania’s openness to foreign companies.

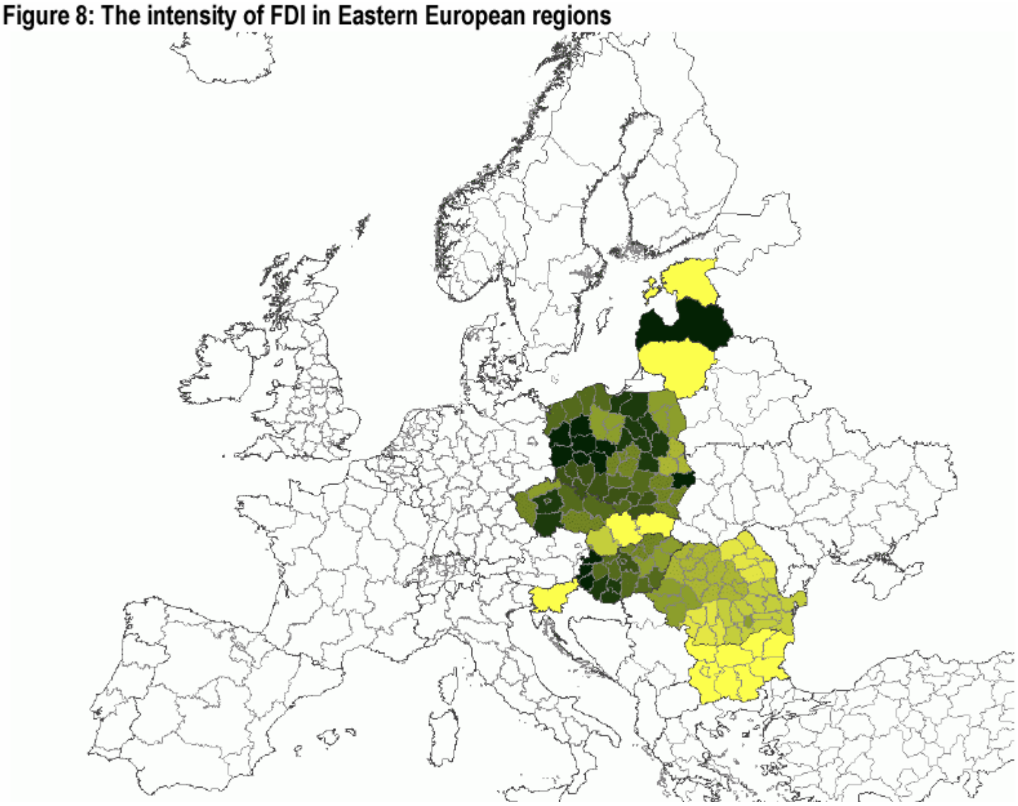
Most changes and reforms within the business environment and the FDI framework were due to Romania’s need to fulfill its EU adhesion agenda, these reforms being inline with the EU regulations and requirements.

4. EVOLUTION OF THE FDI INFLOWS IN ROMANIA, 1990 - 2007

4.1. FDI Flows Towards Romania Comparing to the SEEC-8, CEC-5 and EU

Image 4.1.1. – The intensity of FDI in Eastern European regions - 2006

Figure 8: The intensity of FDI in Eastern European regions



Source : European Commission – Directorate General for Regional Policy, *Study on FDI and regional development* (Copenhagen:2006), accessed at http://ec.europa.eu/regional_policy/sources/docgener/studies/pdf/fdi2006.pdf, on 12/03/09
Note: The intensity of FDI is calculated as the number of employees in foreign firms to total employees in the region. The light yellow accounts for low FDI intensities.

After the fall of Berlin wall, the transition process started for most of the countries in Central and Eastern Europe. Market liberalization and penetration of the local market by foreign goods and services through trade or FDI, were some of the most important issues of transition. After the start of the transition process, it was obvious that there was a huge gap between the amounts of FDI attracted by the transition countries, some of the countries accounting for a large percentage of the inflows amount whereas, in the opposite corner, other countries in the region were the hosts of very low FDI inflows.

Romania is one of the main FDI recipients in SEEC-8, the FDI flows attracted being the highest among the SEEC-8 since 1990 and above their average. In 2007 the amount of FDI flows received by Romania of 9774 million USD was 2.55 times higher then the average and represented 30% of the total FDI flows attracted by the SEEC-8, raising the FDI stock of Romania to 60921 million USD and accounting for 35% of the total FDI stock received since 1990 by the SEEC-8[130].

Still, comparing to the CEC-5, the FDI flows in Romania seem rather low for the period 1990 – 2002, 2003 being the year when the FDI flows values in Romania started approaching the ones in Czech Republic and Hungary. The champions in receiving FDI among the CEC-5 countries are Poland, Czech Republic and Hungary. In 2007 the FDI stock of Romania represented 15.5% of the total FDI stock received by the CEC-5, following a huge growth from 1.7% in 1991 and 8% in 2000 but it was 2.33 times lower then the FDI stock of Poland[131].

As compared to the EU amount of FDI, the FDI in Romania look very modest. In 2007 the FDI stocks of Romania represented only 1.2 % of the EU FDI flow 0.8 % of the EU FDI stock, showing that Romania is still not one of the favorite investment destinations compared to the other EU member states[132].

Taking into consideration the population and the economical situation, Romania appears as less successful in attracting FDI compared to all three groups of countries. In 2007, the FDI stock per capita in Romania was 1500 USD, representing only 51% of the average for the CEEC-8 countries of 2893 USD and being 4.8 times less than the average in the CEC-5, showing still unexplored growth potential. In the same year, the FDI flow accounted for 37% of the GDP, which is 13% below the SEEC-8 average of 50% and 11% less than the CEEC-5 average, the only countries

[130] see ANNEX 1 and ANNEX 2
[131] see ANNEX 2
[132] see ANNEX 1 and ANNEX 2

having lower percentages than Romania being Albania with 22% and Slovenia with 23%. Compared to the EU averages, the statistics are not in favor of Romania either. The EU FDI stock per capita of 13904 USD is 9.72 times higher than in Romania but the percentage of FDI in the GDP in Romania is only with 4% less than EU average. This demonstrates that the rate of contribution by the foreign investors to the economical growth is lower in Romania than in the seven countries in the SEEC-8 and four in the CEC-5[133].

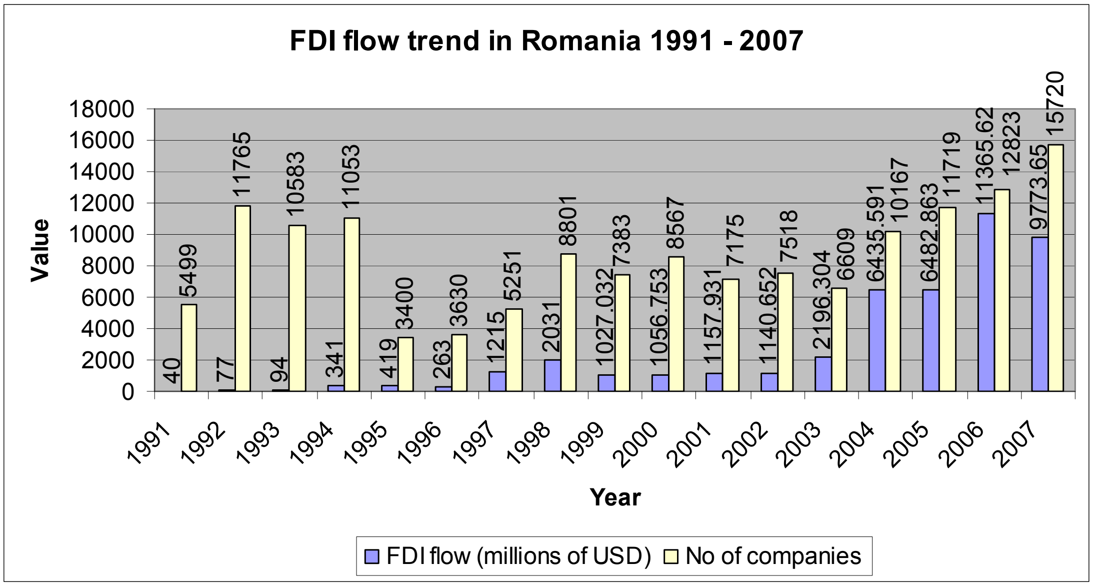
4.2. FDI Flows in Romania

Being one of the transition countries Romania needed and still needs a sustainable economical growth in order to catch up with the developed countries in Western Europe. The economic development is helped by the local companies and their contribution to the national GDP but the foreign investors play an important role, too. They contribute to the integration of Romania within the international market and have a greater financial and economic potential than most of the internal companies. They inject huge amounts of money in the economy and offer many new job opportunities, contributing to the growth of the national economy.

[133] see ANNEX 3 and ANNEX 4

4.2.1. FDI Flows and the Main Macroeconomic Indicators

Figure 4.2.1.1. – Trend in FDI flow in Romania, 1990 - 2007



Source: UNTCAD, www.untcad.org, website visited 21/05/09

The FDI flows in Romania experienced major fluctuations since 1990. The first year with significant FDI flows was 1992, almost double than the previous year, due mostly to the 1992 initiative of the small scale privatization[134]. During the next 4 years the FDI flows continued to grow but not as expected, even if stabilization programs were put into practice to accelerate the privatization process and market oriented reforms were voted in order to achieve macroeconomic stability[135]. The low FDI inflows during 1990-1996 are explained by the fact that this was the immediate period after the communism era when the Romanian government had just started its reform agenda, this period being characterized by many social and economic changes and also by a delay in promoting the market mechanism. The low FDI inflows were also influenced by the continuous decrease of the GDP that went down from 38

[134] Serbu S. G., *FDI flows towards CEECs: an analysis on the Romania, Hungary and Slovenia's performances*(2005), p. 8, University of Orleans, France and "Babes-Bolyai" University, Cluj-Napoca, Romania, accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=873474, on 15/03/09
[135] see subchapter 5.3.3 – "Business Environment"

billion USD in 1990 to 19 billion USD in 1993, causing the GDP per capita to decrease by 50%. This economic decline could be felt easily by the population, the purchasing power per capita (GDP in PPP per capita) decreasing by 18% in this period and leading to the drop of the national demand. The year 1993 marked the beginning of a positive trend of the GDP till 1996, the GDP rising by 34% and the purchasing power per capita growing in 1995 after a decline period and surpassing for the first time since 1989 the value registered in 1990. This shows once again the inefficiency of the reforms and the very slow moving transition and restructuring process in Romania and marks the moment when the living standards in Romania started improving. This economical growth led to an increase in the demand of the population and thus new FDI flows were attracted by Romania as a destination. In 1994 the FDI flows grew 2.6 times comparing to the previous year and the ascending trend was kept for the following year too.

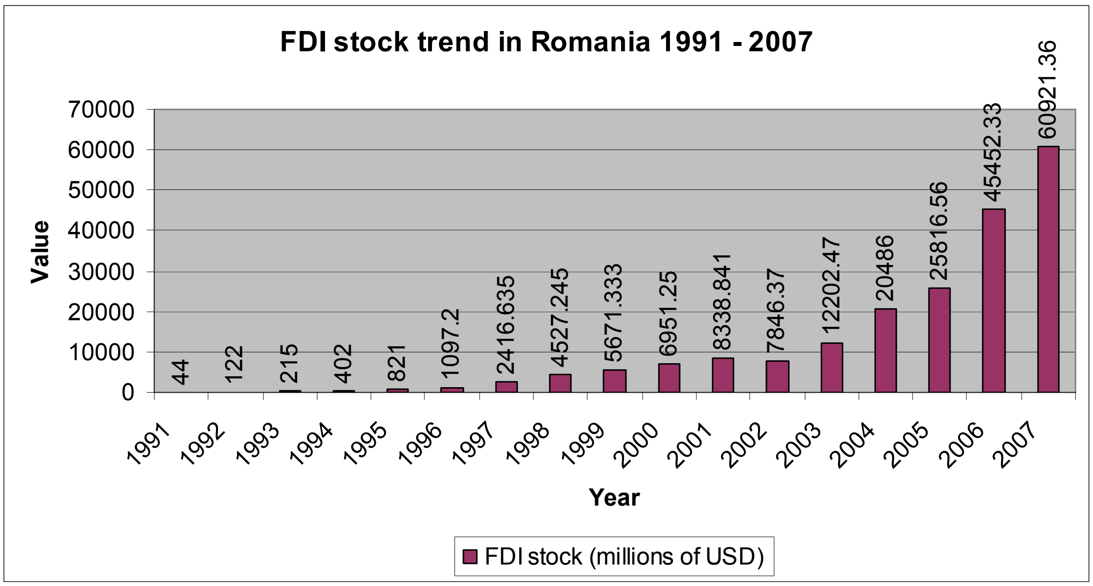
During this period the FDI's contribution to the GDP formation was insignificant, ranging from 0.14% of GDP in 1991 to 1.18% of GDP in 1995, showing the low contribution of the foreign investors to the economical development and their small importance within the national economy.

The years 1997 and 1998 brought a considerable increase in FDI flows, too. In 1997 the FDI flows increased 4.8 times comparing to 1996 and the year 1998 with 2030 millions USD saw an increase of almost 70% in FDI flows and was the highest since 1990 and till 2004. The huge increase in FDI flows contributed to a huge rise of FDI stock in 1997 of around 120%, the FDI stock keeping the same ascending trend for 1998 when it grew by 90% going up to 4527.24 million USD. This rise can be qualified as positively being influenced by the development of the business environment during the previous years[136] showing Romania's openness towards the foreign investors. The reforms made were the consequence of the actions made by the Romanian government towards the EU integration and are due to fulfilling the engagements taken by signing the Association Agreement with the European Union in 1993 and the official submission of the EU membership application in June 1995.

[136] see subchapter 3.2.3. – Business Environment

Even if the FDI flows increased considerably in this period, they did not help the national economy going up, facts proved by the negative trend of the GDP. Following the internal difficulties, the national currency lost its value[137] and the production decreased considerably.

Figure 4.2.1.2 – Trend in FDI stock in Romania, 1990 – 2007



Source: UNTCAD, www.untcad.org, website visited 21/05/09

Another positive effect of the large FDI inflow in 1998 was their contribution to the exports of Romania, contribution that grew to 24%, meaning a growth of 10% comparing to the precedent year. The FDI helping the exports raise shows their contribution to equilibrate the balance of trade[138], an equilibrate balance of trade showing that the exports and the imports of a country are equilibrate and thus being the sign of a healthy, well-functioning and stable economy.

In 1999, the FDI flows went down comparing to the precedent year, phenomenon that can be explained by the Kosovo war that affected the trade in the

[137] the rate exchange trend : www.bnro.ro, website visited 07/04/2009
[138] balance of trade = exports - imports

region and the infrastructure of transports and thus the local market that was one of the most important factors in attracting foreign investors.

An important aspect for the FDI flows received by Romania was their increase within the GDP. 1997 saw a significant increase from 0.74% of GDP to 3.46% of GDP, trend which was kept for the following year, demonstrating the growing importance of the foreign investors in the national economy.

Table 4.2.1.1. – The trend of the macroeconomic indicators in Romania, 1990 - 2007

Indicator/ Year	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**
GDP (billions of USD)	38	30	20	26	30	35	35	35	42
GDP/capita (USD/capita)	1648	1278	848	1148	1318	1564	1566	1567	1886
GDP in PPP (billions of PPP)	132	119	111	115	123	134	142	136	130
GDP in PPP/capita(units/capita)	5693	5138	4814	5028	5370	5906	6290	6040	5842
Annual growth rates of GDP	..	..	..	..	..	7.14	3.95	-6.05	-4.82
Per capita annual growth rates of GDP	..	..	..	..	..	7.76	4.50	-5.59	-4.37
FDI % of GDP	..	0.14	0.39	0.36	1.13	1.18	0.74	3.46	4.83
FDI % of exports	0	1	2	2	6	5	3	14	24
Indicator/ Year	**1990**	**1991**	**1992**	**1993**	**1994**	**1995**	**1996**	**1997**	**1998**

Indicator/ Year	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
GDP (billions of USD)	36	37	40	46	60	76	99	123	166
GDP/capita (USD/capita)	1608	1676	1825	2088	2721	3466	4555	5668	7697
GDP in PPP (billions of PPP)	131	136	148	158	170	189	203	226	246
GDP in PPP/capita(units/capita)	5886	6172	6711	7204	7769	8676	9339	10433	11401
Annual growth rates of GDP	-1.15	2.15	5.75	5.12	5.22	8.45	4.07	7.90	6.00
Per capita annual growth rates of GDP	-0.69	2.63	6.25	5.62	5.72	8.95	4.54	8.38	6.46
FDI % of GDP	2.87	2.85	2.88	2.49	3.69	8.52	6.55	9.27	5.89
FDI % of exports	12	10	10	8	12	27	23	35	24
Indicator/ Year	**1999**	**2000**	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**

Source : data provided by the IMF – http://www.imf.org/external/index.htm, website visited 03/04/2009

The year 2000 marked the beginning of new and very favorable perspectives for the foreign investors with the implementation of new reforms concerning the improvement of the fiscal system and the privatization acceleration, process that was speeded by the official start of Romania's negotiations for the EU membership in

February 2000[139]. The FDI flows are constant during the following year, facing a small decrease in 2002 but having a significant growth in 2003 by 93%, change mostly due to the modification by the National Bank of Romania of the methodology of calculating the FDI flows, by including the reinvested profit and the intra-company loans ("Intra-company loans or intra-company debt transactions refer to short or long term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises (child enterprises)"[140]). The year 2004 marked a record increase for the FDI flows by 193%, the highest since 1990, raising the FDI stock by 67% up to 20486 million dollars.

These remarkable FDI flows were mainly due to the mass privatization process, the so called privatization-related FDI, initiated by the Romanian government during the EU accession negotiations period (2000 - 2004)[141] and had a positive effect on the economical situation of the country. A period of sustainable economical growth started in 2000, marked by the positive trend of the GDP that increased by 103% in 2004 compared to 2000 and by the raise of the purchasing power per capita by 40% for the same period. The high amounts of FDI contributed to the country's exports for 27%, a raise from 12% in 2003 that helped equilibrate the imports in the balance of trade.

During this period the FDI's contribution to the GDP increased significantly, the FDI accounting in 2004 for 8.52% of GDP. It's a significant increase comparing to previous years, showing the Romanian economy tendency to integrate in the European and World market.

The period 2000 – 2004 is thus characterized by economical stability and development and by the successful implementation of new reforms, the most important negotiations chapters for the business environment and the investors being concluded and signed during this period: Chapter 1 – Free movement of goods, Chapter 4 – Free movement of capital, Chapter 6 – Competition policy, Chapter 10 –

[139] the website of the Romanian Ministry of Foreign Affairs, www.mae.ro, visited on 27/03/09
[140] UNCTAD, *World Investment Report 2007: Transition Corporations, Extractive Industries and Development* (2007), p. 246
[141] see subchapter 5.3.2. – "Privatization"

Taxation, Chapter 21 – Regional policy and structural instruments coordination, Chapter 28 – Financial control, fact that led to the signing of the Accession Treaty in Luxembourg on the 25th of April 2005[142].

Due to the annual growth rates for the national economy of around 5% starting with the year 2000 and lasting for the next six years, the private demand increased fast, causing the need of new investments for 2006 that became the peak year of the FDI inflows that went up to 11365.61 million USD, increasing by 75% and raising the FDI stock at 45452.33 million USD, that means an increase of 76% of FDI stock in only one year. The high FDI flows in 2006 are closely linked to the mass privatization that took place this year, the privatization-related FDI accounting again for a great share in the FDI flows. Another FDI determinant was the sustainable growth that started in 2000 and had positive effects both for the national economy, the GDP increasing by 7.9 %, the second performance after 2004 and for the citizen's living standards, causing the GDP per capita to have the highest raise since 1990 (8.38%) . The year 2006 is noticeable also for the FDI inflows reaching 9.27 % of the GDP, the highest percentage since 1990, showing the growing importance of the foreign companies in the economic growth, and also for the highest contribution of the FDI to the Romania's exports since 1990 that reached 35%, meaning that more than one third of the exports were due to the foreign investors coming to Romania. The change of business environment due to the implementation of many reforms needed to complete the EU accession negotiation chapters [143] in the awake of the EU accession and the future possibilities that Romania would offer as an EU member since the following year, 2007, could also be considered as important incentives for the foreign investors.

The year 2007, the first year of EU membership for Romania, brought a decline in the FDI inflows by 14% that did not have a negative influence on the

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[142] the website of the Romanian Minister of Foreign Affairs, www.mae.ro, website visited 27/03/09

[143] European Commission, *Monitoring Report on the state of preparedness for EU membership of Bulgaria and Romania* (2006), p. 5-6 and 9-10 , consulted on http://ec.europa.eu/enlargement/pdf/key_documents/2006/sept/report_bg_ro_2006_en.pdf, website visited 25/05/09

economical development, the GDP continuing its ascending trend and the annual growth per capita going up by 6.46%, still the growth being more modest than the one in the precedent year. The decrease of the FDI can be explained by the still not well-functioning judicial apparatus and the corruption present in the administrative environment, the two main issues that Romania still has to resolve after the EU integration and that represent huge obstacles for the foreign investors coming to Romania, even if the business environment has significantly improved[144]. The second factor that explains the low FDI inflows are the rising salaries that reached the point where Romania is not rentable anymore as a destination for investment, many foreign investors preferring to move or to start an investment in countries with lower salaries. This is proved by the data in the table 4.2.1.2, showing that the average salary in Romania in 2007 was 83% higher than the one in Bulgaria that became an EU member in 2007 too.

Table 4.2.1.2 - Average gross monthly earnings in industry and services (euros) - Of full-time employees in enterprises with 10 or more employees

Country/Year	2004	2005	2006	2007
Bulgaria	148.68	164.81	182.92	218.83
Romania	201.18	262.92	309.43	402.37

Source: the EUROSTAT database

The third factor that contributed to the FDI decrease was the declining trend in the privatization process in 2007[145] causing the decrease of the privatization-related FDI that had an important share in the FDI flows from the previous year and also in the total FDI stock received by Romania since 1990, accounting for almost

[144] European Commission, *Monitoring Report on the state of preparedness for EU membership of Bulgaria and Romania* (2006), p. 5 , consulted on http://ec.europa.eu/enlargement/pdf/key_documents/2006/sept/report_bg_ro_2006_en.pdf, website visited 25/05/09

[145] see Table 3.2.2.1.2. from the subchapter 3.2.2-“Privatization”

half of the total FDI stock at the end of 2007[146]. Even if the privatization program was less intense in 2007 than in 2006 causing a decrease in share of the privatization-related FDI, the volume of non-privatization-related FDI seemed to stay stable during 2007[147], showing that FDI in Romania after the EU integration are not closely linked to the privatization process.

4.2.2. FDI Flows and Their Distribution

4.2.2.1. By Sector Distribution

- **1990 – 2004**

The sectoral distribution of FDI proves a large concentration in industry with more than half of the foreign companies that came to Romania, 53%, but also in services (services rendered to enterprises, post and telecommunication, financial services, etc) and trade, 14.5%. The large number of foreign investors having chosen to invest in the industry, which is the most important source of Romania's exports and the major branch in the economy, is a proof of Romania's interdependence with the world economy and of its great integration into the European market.

The construction industry, even if it accounts for only 1% of the foreign investments, offers good perspectives, especially in the area of constructing shopping centers and office buildings. Most of the new constructions are meant for the new–coming foreign companies and are done with the help of foreign companies, offering many new employment opportunities for the local population. Another very promising field for receiving FDI in this period was represented by the services offered through the IT industry, Romania having very high skilled personnel in software developing and thus attracting investments in the area too[148].

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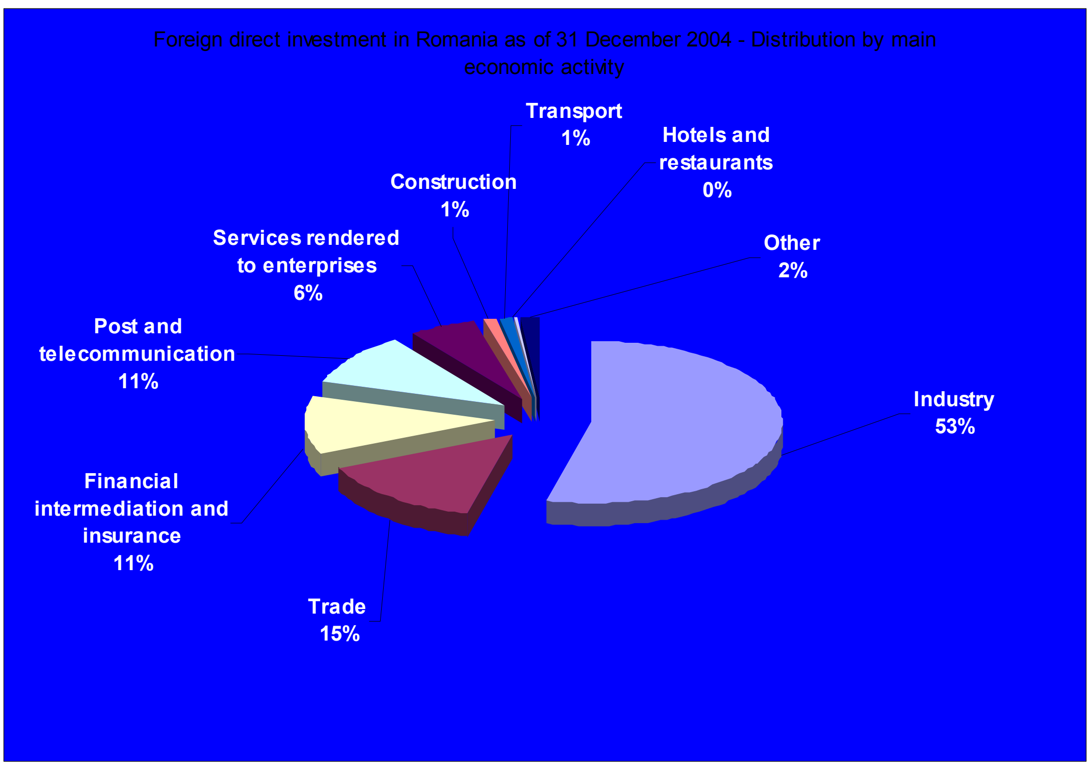
[146] European Commission's Directorate General for Economic and Financial Affairs, *FDI in Romania: from low-wage competition to higher value-added sectors* (2008), p. 2, accessed at http://ec.europa.eu/economy_finance/publications/publication11881_en.pdf
[147] idem
[148] Gabor Hunya, *FDI in South East Europe in 2003-2004* (Vienna : 2004), p.9-10, OECD, accessed at http://www.stabilitypact.org/investment/2004,%20FDI%20in%20SEE.pdf, 20/05/09

Within the industry, manufacturing plays a major role among the fields of investment favored by foreign companies with more 2941 million USD of investment flows and 45.7% of the total foreign investments in 2004. The FDI in manufacturing can be catalogued as relatively reduced compared to the country size, but it is almost similar to the total amount in the other SEECs, Romania being the only SEEC with an important export-oriented foreign manufacturing sector. The most noticeable FDI coming to the manufacturing industry have been registered in the intensive steel industry, the clothing and leather industries, the chemicals industry and the car component and electrical machinery manufacturing industry[149].

Figure 4.2.2.1.1. – Percentage of companies with foreign investment, between 1991 and 2004, on fields of activity



Source: the National Trade Register Office of Romania, www.onrc.com, website visited 19/03/2009

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[149] Gabor Hunya, *FDI in South East Europe in 2003-2004* (Vienna : 2004), p.9-10, OECD, accessed at http://www.stabilitypact.org/investment/2004,%20FDI%20in%20SEE.pdf, 20/05/09

In May 2004, the Japanese company Yazaki opened two manufacturing plants for car components in the industrial park from Ploiesti and the German company Draxlmaier inaugurated a plant that is worth around 15 million euros in the Western part of the country, in Hunedoara, company that had around 600 employees when inaugurated. Also in 2004, another German company, Ruwel, a car electronics supplier, decided to invest in Cluj to produce integrated circles, with an investment of 80 million euros, employing around 600 people[150].

In the steel industry the main foreign investor is the Indian – British company LNM Holding that took over SIDEX Galati in 2001, the main Romanian steel producer, turning it into Ispat Sidex, and continued with more investment, enlarging the export base of the company. In 2003 the investments reached 100 million USD, including the acquisitions of the steel producer Tepro and of the tube-maker Petrotub. The privatization and integration of the state – owned company SIDEX Galati into the LNM Holding and the follow-up investments made it a rentable company with more than 70% of the production going for export[151].

Table 4.2.2.1.1 - Foreign penetration in the manufacturing industry – 2004

Industry	% of foreign penetration
food industry	32.10
non-metallic mineral products	38.2
metallurgy	38.3
machines and equipment	30.6
electrical and optical equipment	49.6
means of transportation	49

Source: OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), pp. 22-23

The manufacturing sector is one of the sectors with most foreign penetration, the foreign companies accounting for 30% of the turnover and more than one third of the share capital of the sector in 2001, a huge step from the 5% they had in 1995. The

[150] Gabor Hunya, *FDI in South East Europe in 2003-2004* (Vienna : 2004), p.10, OECD, accessed at http://www.stabilitypact.org/investment/2004,%20FDI%20in%20SEE.pdf, 20/05/09
[151] idem

manufacturing exports by the foreign investors accounted for 44% in 2000 and in 2002 the foreign investors' output surpassed 50%, employing one third of the total workforce in the industry, ratios that are similar to what the Czech Republic recorded a few years earlier, bringing Romania closer to the developed Western European countries. [152]

The manufacturing activities with high foreign penetration are the electrical and optical equipment with 49.6% and the means of transportation with 49% and they are at the same time the activities with the highest relative productivity gains in the period 1995 - 2001[153].

Table 4.2.2.1.2 – Foreign direct investment in Romania as of 31 December 2004 - Distribution by main economic activity

Sector	Value (millions of USD)	% of total
Total, of which:	6435.59	100.00
Industry	3462.35	53.80
a) Mining	521.28	8.10
b) Manufacturing	2941.06	45.70
-metallurgy	849.50	13.20
-food,beverages and tobacco	476.23	7.40
-transport means	366.83	5.70
-cement,glassware,ceramics	257.42	4.00
-wood items,including furniture	218.81	3.40
-textiles,wearing apparel,leather goods	212.37	3.30
-computers,electrical apparatus,radio and TV sets, communications	186.63	2.90
-crude oil processing and plastic products	167.33	2.60
-machinery and equipment	115.84	1.80
-other	90.10	1.40
Trade	933.16	14.50
Financial intermediation and insurance	733.66	11.40
Post and telecommunication	682.17	10.60
Services rendered to enterprises	360.39	5.60
Construction	70.79	1.10
Transport	70.79	1.10
Hotels and restaurants	12.87	0.20

Source: the National Bank of Romania, www.bnro.ro, website visited 24/04/2009

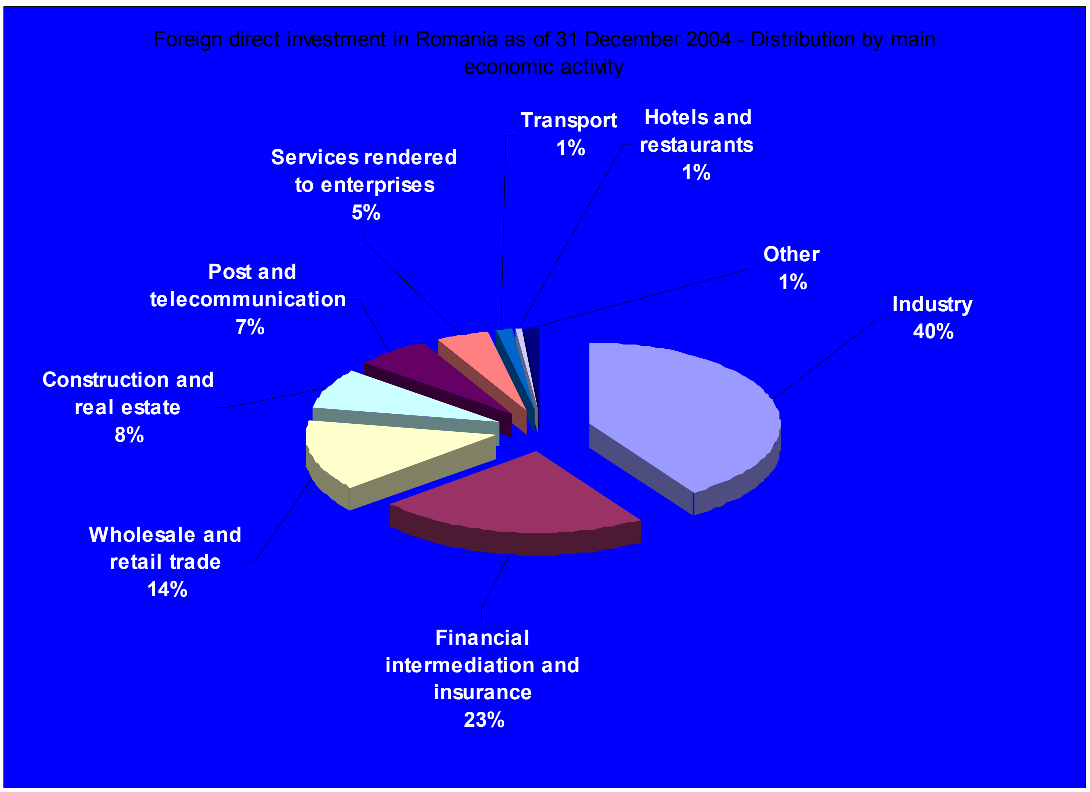
[152] Gabor Hunya, *FDI in South East Europe in 2003-2004* (Vienna : 2004), p. 10, accessed at http://www.stabilitypact.org/investment/2004,%20FDI%20in%20SEE.pdf, on 20/05/09

[153] Gabor Hunya, *Restructuring through FDI in Romanian Manufacturing* (Vienna : 2002), p. 4, accessed at http://www.sciencedirect.com/science/article/B6W8Y-47NF419-2/2/8e13c2db89fac0937bb08b15f51f4334, on 19/05/09

The high degree of penetration of FDI in Romania is possible due to the cheap workforce and the low costs needed for acquiring firms and assets that translate into less capital necessary for the same production capacity.

- **2004 – 2007**

Figure 4.2.2.1.2. – Percentage of companies with foreign investment, in 2007, on fields of activity



Source: the National Trade Register Office of Romania - www.onrc.com, website visited 06/03/09

In 2007 the situation in the distribution of the foreign companies doesn't suffer significant changes since 2004, the industry remaining the dominant sector. The major change comes from the construction and real estate sector that grew up 8 times in percentage, going up to 8%, and more than 10 times in the amount invested by the foreign companies, going from 70.79 millions USD in 2004 to 762 millions

USD in 2007. The second most important change in the sectored structure of the FDI comes from the financial and insurance sector that accounts in 2007 for 23% of the foreign investments which represents the double of the percentage it had three years earlier and a rise of the capital invested by the foreign affiliates of three times to 2247.94 millions USD.

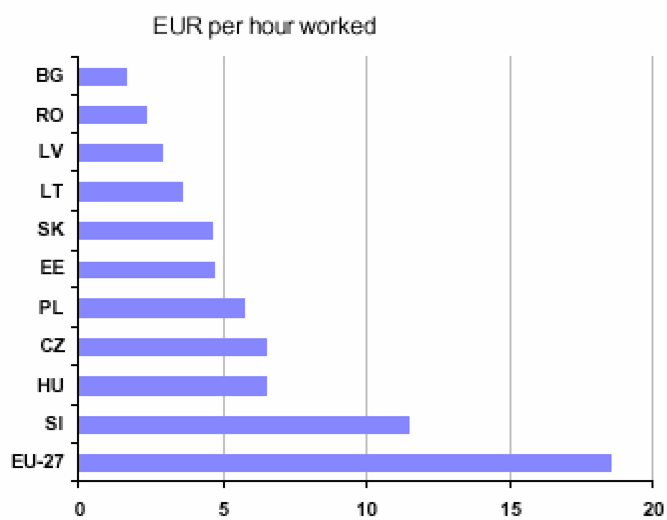
Table 4.2.2.1.3 – Foreign direct investment in Romania as of 31 December 2007 - Distribution by main economic activity

Sector	Value (millions USD)	% of total
Total, of which:	9773.64	100.00
Industry	3977.87	40.70
a) Mining	469.13	4.80
b) Manufacturing	3215.53	32.90
-metallurgy	733.02	7.50
-food,beverages and tobacco	508.23	5.20
- oil processing, chemicals, rubber and plastic products	430.04	4.40
-transport means	351.85	3.60
-cement,glassware,ceramics	342.08	3.50
-wood items,including furniture	234.57	2.40
-computers,electrical apparatus,radio and TV sets, communications	166.15	1.70
-textiles,wearing apparel,leather goods	185.70	1.90
-machinery and equipment	127.06	1.30
-other	136.83	1.40
c) Electricity, heating, natural gas, water	293.21	3.00
Financial intermediation and insurance	2247.94	23.00
Wholesale and retail trade	1368.31	14.00
Construction and real estate	762.34	7.80
Post and telecommunication	635.29	6.50
Services rendered to enterprises	439.81	4.50
Transport	117.28	1.20
Hotels and restaurants	58.64	0.60
Other	136.83	1.40

Source : own compilation using data from the National Bank of Romania, www.bnro.ro, website visited 24/04/2009

The most important component in the FDI in industry remains the manufacturing that goes up to 3215.53 millions of USD, but loses 13% in the sectored structure of the FDI, meaning that the foreign investors changed preferences due to the ascending tendency of the salaries, Romania not being anymore one of the countries with the cheapest workforce in order to make their investment rentable[154].

Figure 4.2.2.1.3. - Hourly labor cost in euros in some EU countries, end 2006

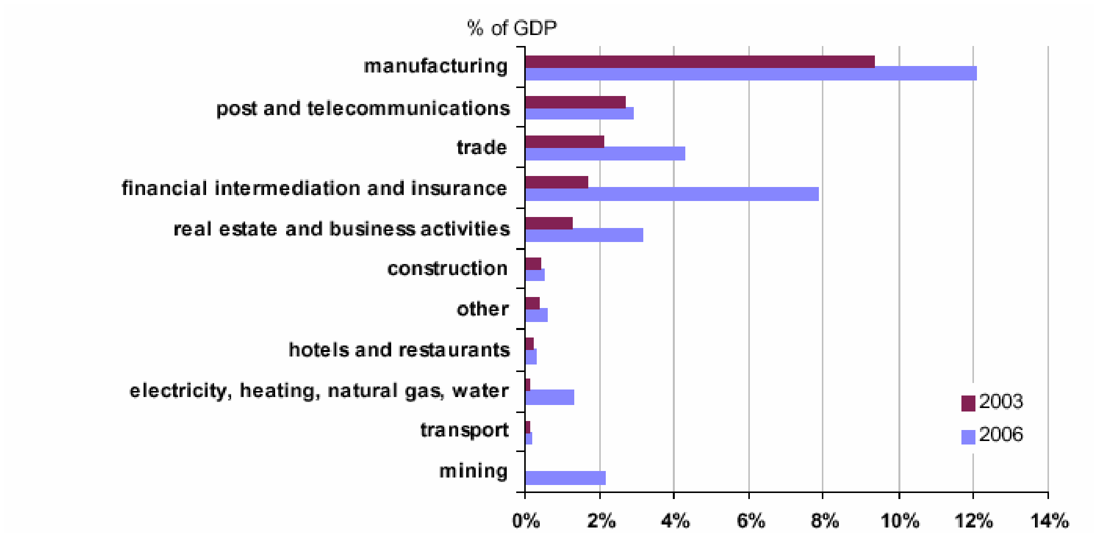


Source: European Commission's Directorate General for Economic and Financial Affairs, *FDI in Romania: from low-wage competition to higher value-added sectors* (2008), p. 5, accessed at
http://ec.europa.eu/economy_finance/publications/publication11881_en.pdf

The aspects mentioned above prove the change in the investors' interests from exploiting the advantage of the low-cost workforce (the decrease in the FDI flows received by the manufacturing sector) to higher-value added production (the rise of the FDI flows received by the service sector, namely the financial services).

[154] see Table 5.1.2 - Average gross monthly earnings in industry and services (euros) - Of full-time employees in enterprises with 10 or more employees

Figure 4.2.2.1.3. – Sectoral comparison of the FDI flows for 2003 and 2006, Romania



Source: European Commission's Directorate General for Economic and Financial Affairs, *FDI in Romania: from low-wage competition to higher value-added sectors* (2008), p. 2, accessed at http://ec.europa.eu/economy_finance/publications/publication11881_en.pdf

The construction and real estate industry keeps a similar line as three years ago being dominated by the construction of office buildings, shopping centers and blocks of flats. The rise of the construction and real estate industry is mostly due to the need of new office spaces for the foreign investors, the penetration of the local market by many new clothing companies and restaurant chains in need of spaces for renting, many of these arrivals taking place in 2006, the year ahead Romania's integration into EU and the year with the highest FDI flows[155].

The rise of FDI in the financial and insurance sector started with the successful privatization of the state – owned banks: the Romanian Development Bank sold to Société Générale in 1998, the Agricultural Bank sold to Raiffeisen Bank in 2001, the Romanian Commercial Bank – the most important bank in the Romanian banking system - sold to Erste in 2005 that paid approximately 3.75 billion euros for 61.88% of shares, making it by far the most important privatization act in Romania

[155] the Romanian Ministry of Economics, http://www.minind.ro/, accessed at 09/04/09

that is almost equal to the value of all the privatization acts made since 1990 and the CEC Bank (Romanian Savings Bank) – the bank with the most branches in Romania – sold to the National Bank of Greece in 2007[156]. Besides the privatizations, investments in the banking sectors have been made by foreign banks willing to come on the Romanian market. They were attracted by the huge potential of both the financial and insurance markets. The financial market grew significantly due the foreign and internal investors taking loans for new investments and the population starting to take credits, especially for buying apartments and cars, due to the faster growth of prices on the real estate market than the growth of the salaries. The positive trend of the insurance market is caused by the people's growing tendency in having insurances – insurances for health, life, cars, housing, etc. –, by the private pensions systems, alternative chosen by more and more employees and by the new pensions system in Romania that was fully implemented at the end of 2007 and that obliged each employee to choose a private insurance company that he/she would pay the pension contribution to while being employed[157].

The IT industry is another example among the industries with high foreign investments. The value of the software and IT services sold in Romania in 2007 was estimated at around 660 million euros, growing by 23% compared to 2006. This rise was based mainly on the sales of software system infrastructure and on project services. In spite of the good growth rate and of the country's size, the IT expenditure in Romania (services, hardware, personnel, software and miscellaneous) represents only 5% of the total amount spent in 2007 in the Eastern European region. Most of the international companies investing in the IT industry are based on Greenfield investments and, by coming to Romania, companies like SAP, Oracle, Siemens Microsoft, IBM, Ericsson, Genpact, Adobe and others have created many new

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[156] Larive Romania International, *Foreign Direct Investments in Romania* (Bucharest : 2008), accessed at http://rbd.doingbusiness.ro/en/2009/april/romanian-business-climate/1/149-foreign-direct-investment-in-romania.html, on 04/02/09

[157] European Commission's Directorate General for Economic and Financial Affairs, *FDI in Romania: from low-wage competition to higher value-added sectors* (2008),p. 2, accessed at http://ec.europa.eu/economy_finance/publications/publication11881_en.pdf and Romania's Ministry of Finance http://www.mfinante.ro/, accessed at 06/05/09

positions for the Romanian employees, causing the very fast salary growth for the software developers and IT-skilled engineers but also for the people with foreign language abilities, most of these foreign companies being located near Bucharest. The very fast salary inflation made Romania a more expensive destination for the existing and also for the potential foreign investors in the IT area than other CEEC's or countries like India, the situation being similar to the manufacturing industry, many of these companies preferring to relocate in countries with less expensive workforce.[158]

4.2.2.2. By Origin of the Foreign Investor

Table 4.2.2.2.1. – Distribution of the FDI in Romania by the origin country of the foreign investor – 2007

	Amount of subscribed capital		No of companies	
	Total on USD			
Country	millions USD	%	No of companies	%
Total ROMANIA	**9773.64**	**100.00**	**122378.00**	**100.00**
NETHERLAND	1606.79	16.44	2689.00	1.82
AUSTRIA	1012.55	10.36	4191.00	2.84
GERMANY	792.64	8.11	14216.00	9.63
FRANCE	776.03	7.94	4693.00	3.18
ITALY	431.99	4.42	21524.00	14.58
U.S.A.	367.49	3.76	4919.00	3.33
GREAT BRITAIN	343.05	3.51		1.83
CYPRUS	302.98	3.10	2414.00	1.63
ANTILELE OLANDEZE	285.39	2.92	12.00	***
GREECE	275.62	2.82	3610.00	2.44
TURKEY	225.77	2.31	9641.00	6.53
SWITZERLAND	216.97	2.22	1692.00	1.15
I.VIRGINE BRIT.	167.13	1.71	250.00	0.17
SPAIN	158.33	1.62	1742.00	1.18
HUNGARY	153.45	1.57	6534.00	4.42
LUXEMBOURG	104.58	1.07	542.00	0.37
CHINA	94.80	0.97	8647.00	5.86

[158] Pierre audion consultants, *The Romanian Software and IT Services Industry - one year after the EU accession* (Bucharest : 2008), accessed at http://rbd.doingbusiness.ro/en/2008/september/latest-articles/2/47-the-romanian-software-and-it-services-industry-one-year-after-the-eu-accession.html, on 04/02/09

SOUTH KOREA	59.62	0.61	102.00	0.07
SWEDEN	48.87	0.50	920.00	0.62
CANADA	42.03	0.43	1228.00	0.83
JAPAN	39.09	0.40	193.00	0.13
BELGIUM	35.19	0.36	1746.00	1.18
WITH OUT CITIZENSHIP	32.25	0.33	23.00	0.02
LIECHTENSTEIN	28.34	0.29	172.00	0.12
POLAND	27.37	0.28	329.00	0.22
A.R. OF SYRIA	23.46	0.24	5097.00	3.45
LEBANON	23.46	0.24	3248.00	2.20
MARSHALL ISLANDS	20.52	0.21	11.00	***
ISRAEL	19.55	0.20	3989.00	2.70
IRAQ	15.64	0.16	5237.00	3.55
DENMARK	13.68	0.14	404.00	0.27
IRELAND	9.77	0.10	458.00	0.31
NORWEY	7.82	0.08	198.00	0.13
PANAMA	7.82	0.08	133.00	0.09
MOLDAVIA	7.82	0.08	2592.00	1.76
IRAN	6.84	0.07	2473.00	1.67
SLOVENIA	6.84	0.07	80.00	0.05
JORDAN	6.84	0.07	2971.00	2.01
PORTUGAL	5.86	0.06	200.00	0.14
ARGENTINA	5.86	0.06	31.00	0.02
FINLAND	4.89	0.05	82.00	0.06
GIBRALTAR	4.89	0.05	38.00	0.03
ICELAND	4.89	0.05	26.00	0.02
LITHUANIA	4.89	0.05	32.00	0.02
EGYPT	4.89	0.05	1232.00	0.83
AUSTRALIA	4.89	0.05	516.00	0.35
NEW ZEELAND	4.89	0.05	18.00	0.01
THAILANDA	4.89	0.05	15.00	0.01
UNITED ARAB EMIRATES	4.89	0.05	197.00	0.13
CZECH REPUBLIC	3.91	0.04	314.00	0.21
FORMER	3.91	0.04	742.00	0.50
CAMEROON	3.91	0.04	15.00	0.01

Source: the National Trade Register Office of Romania - www.onrc.com, website visited 06/03/09

The European countries and the USA were the main investors in Romania in 2007, Europe accounting for 95.9% of the total invested capital and the USA coming sixth in the top investments countries in Romania.

With more than 16% of the total foreign investment in Romania in 2007, the Netherlands come first in the top of foreign investors. The favorite areas of investment for the Dutch companies are IT, banking and insurance, production and logistics, milk processing, etc. In 2007, 2689 companies on the Romanian market had Dutch capital, the major investments being made by ING (ING Bank and ING Securities), Philips, Unilever, KPMG, Heineken, ABN AMRO Bank, Damen Shipyards Group, SPAR, TNT, Friesland, Verder Group, Golden Tulip Hotels, etc. [159]

In 2007, Austria ranks second in the top of foreign investors in Romania, accounting for 4191 companies having Austrian capital and a total amount of investments during the year of 1012.55 million USD. The most significant Austrian investors in Romania are Erste Bank the buyer of the Romanian Commercial Bank, OMV the company that privatized PETROM the main gas and petrol producer in Romania, Porsche Romania, Raiffeisen, Volksbank, Strabag, Schweighofer, Bramac Baumit Wienerberger, Vienna Insurance (owner of Omniasig and Unita). As seen most of the Austrian companies invested in the banking and insurance area but they are nevertheless interested in investing in fields like real estate, machine construction, construction materials, metallurgy, food industry, etc.[160]

With a total value of investment of 792.64 million USD and 14216 companies registered and operating in Romania, Germany ranks third in the foreign investors' classification for 2007 proving to be one of the most important trade partners of Romania. The main characteristic of the German investments resides in the fact that they are made mostly through small business, 90% of the companies with German capital accounting for only 40,000 euros of capital invested. The importance of the German investments for the Romanian economy is in fact higher than what the figures presented in the table 5.2.2.2.1. show because they do not take into consideration the fact that many German companies have done their investment in Romania through their European branches and not directly. The preferred sectors by the German investors are: metallurgy, the automotive industry, textile industry, financial services, wholesale and retail trade and IT, while Metro, Heidelberger Cement (CarpatCement), Selgros, Praktiker, Billa, Tengelmann (Plus), Kaufland (part

[159] Larive Romania International, *Foreign Direct Investments in Romania* (Bucharest : 2008), accessed at http://rbd.doingbusiness.ro/en/2009/april/romanian-business-climate/1/149-foreign-direct-investment-in-romania.html, on 04/02/09

[160] idem

of Group Lidl & Schwarz), Steilmann, Linde Gas, Dr. Oetker, etc. are among the most important German investors in Romania. [161]

The next positions in the top of the foreign investors in Romania for 2007 are occupied by France that comes fourth with 4693 companies, the leading investors being Orange (investments of over 1 billion euros), Carrefour, Société Générale (invested 830 million euros), Renault-Dacia (investments of over 630 million euros and plans to invest 215 million euros in a new production unit), Gaz de France and Alcatel. The top ten foreign investors in Romania are completed in 2007 by Italy, USA, Great Britain, Cyprus, the Danish Antilles and Greece[162].

The presence of eight EU member states in the top ten of the foreign investors as well as the sixth place held by the USA show the strong trade integration of Romania with the EU and the global market, that can be seen as the result of the spread of the FDI across a large number of Romanian companies, including small and medium sized enterprises. This shows that trade and investments are important and well connected factors when it comes to exploiting and using the comparative economic advantages of Romania[163]

Table 4.2.2.2.2. – Distribution of the FDI in Romania taking into consideration the home country of investors, from various economic groups - 2007

Country	Amount of subscripted capital		No of companies	
	Millions USD	%	No of companies	%
Total ROMANIA	186741.00	100.00	38326140.00	100.00
E.U.	83219.00	44.56	19242878.50	50.21
E.A.F.T.A.	2308.00	1.24	700369.50	1.83
O.E.C.D.	97969.00	52.46	18352767.90	47.89
C.E.F.T.A.	3245.00	1.74	30124.10	0.08

Source: the National Trade Register Office of Romania - www.onrc.com, website visited 06/03/09

The main economic groups investing in Romania are by far OECD and EU. The high percentage of investments made by the EU member states in Romania – 44.52% is another argument for the integration of the Romanian economy within the

[161] idem
[162] idem
[163] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), p. 20.

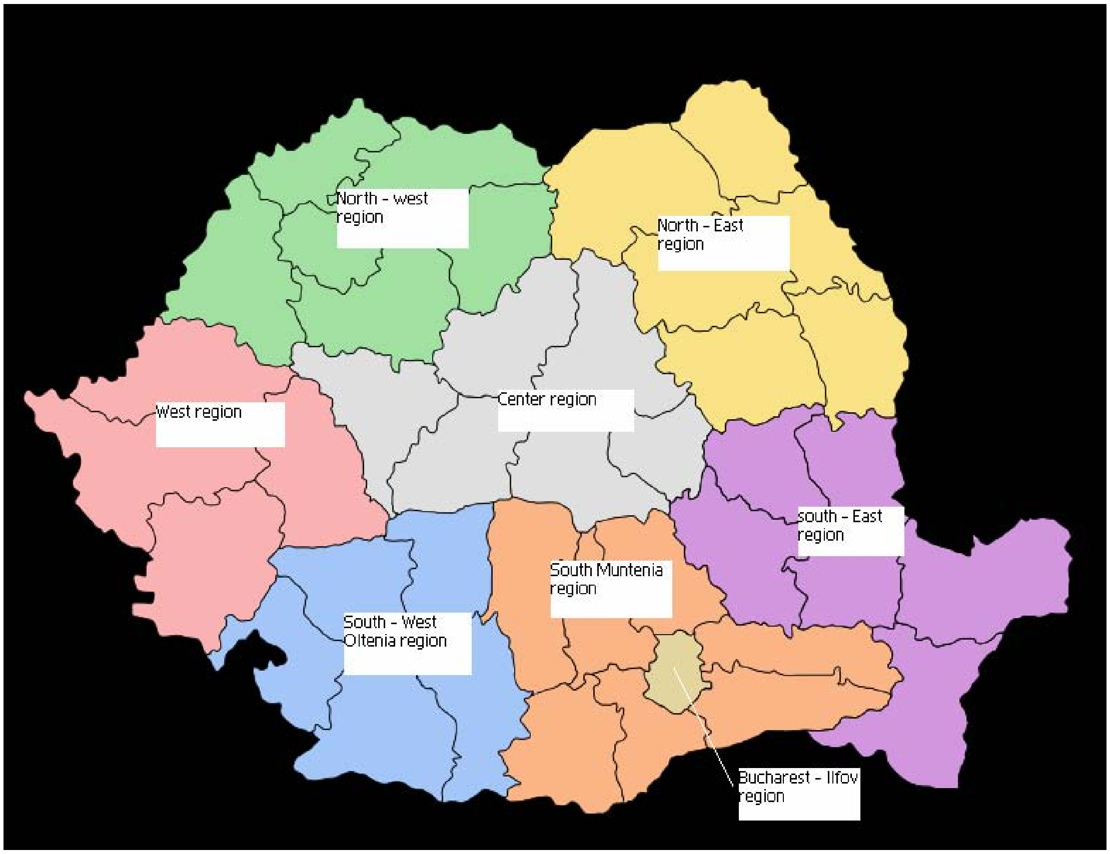
European market, fact demonstrated before by the table illustrating origins of the foreign investors. The high percentage of penetration of the Romanian economy by investors coming from the OECD countries - 52.46% - and from the EU members – 44.56% - is especially due to the arrival on the local market of some large industrial and financial groups, the privatization of the banking sectors or by the delocalization of some economical entities in Romania[164].

4.2.2.3. By the Investments' Location within Romania

The year 2007, like the previous ones, shows a very disparate distribution of foreign investments in the eight development regions within Romania. It is mainly due to the very heterogeneous development areas with big cities not so economically diversified, with mono-industrial, small towns, strongly affected by privatization and the restructuring process and with some urban centers that proved their incapacity of becoming development vectors for the areas around them. The under-developed regions are those where agriculture is predominant, having a great rural population and where transport and the means of communications are very little developed. On the other hand, the developed regions are those that are not relying on agriculture, its percentage in their economy being reduced.[165]

[164] OECD, *OECD Investment Policy Reviews – Romania* (Paris:2005), p. 20.
[165] Corduneanu, C., Iovu, L. R. - *Foreign Direct Investment and Regional Development in Romania* (2007), West University from Timisoara (Romania), Faculty of Economics and Business dministration, Finance Department, accessed at http://mpra.ub.uni-muenchen.de/12926/1/MPRA_paper_12926.pdf, on 24/04/09

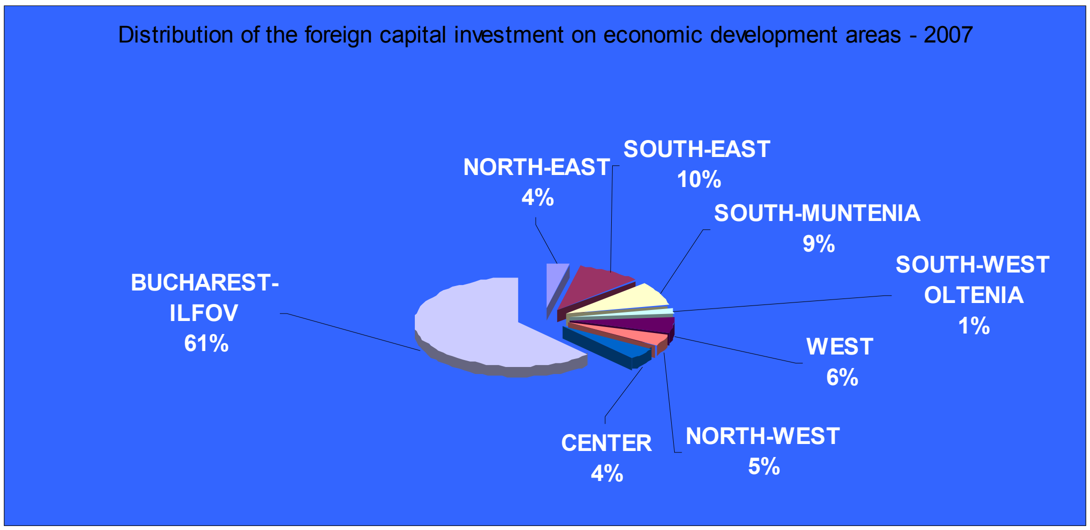
Image 4.2.2.3.1 – The development regions within Romania



Source: the Romanian Ministry of Foreign affairs, www.mae.ro,website visited 06/03/09

The Bucharest – Ilfov region keeps its primacy in receiving foreign investments, accounting for 61% of them and an amount of 6026.43 millions of USD and a number of 76564.00 foreign companies. This situation is motivated by the still precarious transport infrastructure connecting the rest of the country with Europe and the whole world, situation felt especially in South – West Oltenia where there is no airport, by the qualified and very skilled workforce residing in Bucharest – the capital city is the most important academic center in Romania and most of the students start working while still studying and thus being motivated to keep working and living in Bucharest after finishing their studies; another favorable point for the skilled and very well prepared workforce in Bucharest is represented by the professors activating within the universities from Bucharest as well as the very well trained personnel working in all the other companies from the region[166].

Figure 4.2.2.3.2. - Distribution of the foreign capital investment on economic development areas – 2007



Source: the National Trade Register Office of Romania - www.onrc.com, website visited 06/03/09

The second most important region for the FDI flows is the South-East region that benefits from the transport facilities offered by the Black Sea and the Danube[167]. The most important centers in this region are Galati and Constanta. Galati is the city of the steel producer Ispat SIDEX owned by the LMN Holding and of the ship constructor company "Santierul naval Galati", the second ship producer in Romania, privatized by the Dutch company Damen Shipyards Group in 2000[168], while Constanta is the second town of the country in terms of population, the most

[166] the Romanian Ministry of Eurpean Integration, website http://www.mie.ro/mie.htm, accessed 19/05/09
[167] idem
[168] the website of the DAmen Shipyard Group in Romania, http://www.damen.ro/ accessed on 20/05/09

important port in Romania and the forth European port after Rotterdam, Anvers and Marseille[169].

Nevertheless, the foreign investors' interest in the Western regions can be noticed, fact that can be explained by the greater stability of the foreign capital invested in the Western region compared to the other regions of the country, the lower salaries and leaving standards comparing to Bucharest, by the transport infrastructure that has improved lately for this region, the airports in the most important cities in the region being modernized and connected to most of the important cities in Western Europe, but also by the more Western – like life style and mentality from this region. The most important economical centers in the region are Timisoara – the second developed city of Romania after Bucharest and Arad[170].

The other development regions don't have noticeable performances in terms of attracting FDI. The main factors that can contribute to the raise of FDI flows in these regions are the capital stability and a proper infrastructure[171].

Table 4.2.2.3.1 - Distribution of the foreign capital investment on economic development areas - 2007

Country		No of companies	Amount of subscripted capital	
	No of companies	%	Millions USD	%
Total ROMANIA	147663.00	100.00	9773.64	100.00
NORTH-EAST	6052.00	4.10	344.03	3.52
SOUTH-EAST	8146.00	5.52	999.84	10.23
SOUTH-MUNTENIA	6520.00	4.42	831.74	8.51
SOUTH-WEST OLTENIA	3726.00	2.52	133.90	1.37
WEST	16487.00	11.17	559.05	5.72
NORTH-WEST	15465.00	10.47	448.61	4.59
CENTER	14703.00	9.96	430.04	4.40
BUCHAREST-ILFOV	76564.00	51.85	6026.43	61.66

Source: the National Trade Register Office of Romania - www.onrc.com, website visited 06/03/09

169 http://laroumanie.free.fr/tourisme/001/constanta.html, accessed on 20/05/09
170 the website of the DAmen Shipyard Group in Romania, http://www.damen.ro/ accessed on 20/05/09
171 idem

4.2.2.4. By Type of Investment

Table 4.2.2.4.1. - Types of investment and by main economic activity in Romania - 2007

	Greenfield		Mergers and acquisitions		Corporate development	
	USD millions	%	USD millions	%	USD millions	%
TOTAL, of which	1690	17.3	1026.23	10.5	7,037.00	72.2
Industry,of which	126.75	7.5	64.65249	6.3	767.033	10.9
Mining	0	0	0	0	14.074	0.2
Manufacturing	121.68	7.2	64.65249	6.3	971.106	13.8
Electricity,heating, natural gas, water	5.07	0.3	0	0	218.147	3.1
Financial intermediants and insurances	118.3	7	23.60329	2.3	2716.282	38.6
Wholesale and retail trade	6.76	0.4	0	0	569.997	8.1
Construction and real estate	11.83	0.7	15.39345	1.5	506.664	7.2
Post and telecommunications	0	0	0	0	28.148	0.4
Other	28.73	1.7	4.10492	0.4	492.59	7

Source: www.bnro.ro, website visited 20/05/09

The predominant form of FDI in Romania in 2007 was the Corporate development that accounts for 72.2% of the total FDI amount, meaning that in 2007 the FDI were dominated by the investment of capital in the already existing investment enterprises. The second position is occupied by the Greenfield investments that represent 17.3% of the FDI received by Romania for 2007, a small percentage compared to the one for Corporate development but, still, a very good incentive for the economic growth due to the creation of new value on the market that determines the growth of the national GDP and of new employment opportunities. The Mergers and acquisitions come last with only 10.5% of the FDI inflows in 2007.

The impact of the Greenfield enterprises on the economy is known to be long lasting and thus to offer benefits for the country on the short term but mostly on the medium – long run. This is due to the fact that once an investor decides to make a new investment in a foreign country, he invests much time, expertise and financial capital in the new business and is not willing to leave the new business until he/she manages to obtain back, at least, the invested capital[172].

4.3. FDI Determinants in Romania

The aim of the economic analysis above was to find the FDI determinants in Romania. The main findings are presented further on.

As a part of *the transition process and of the reform agenda*, the *privatization process* was one of the main FDI determinants before Romania's EU integration. The privatization-related FDI had great shares within the FDI flows and reached their peak during the mass privatization periods like 2000-2004, the EU accession negotiations period for Romania, and in 2006, the year preceding the officially announced EU integration for Romania. After the EU integration in 2007, the non-privatization-related FDI flows became more significant, keeping their share within the FDI flows, in opposition to the privatization-related FDI that lost in significance. The progress of the reforming of the FDI framework and the transformation of the business environment[173] can also be seen as positive determinants of the FDI flows.

The FDI were also driven by the national *economic development*, an example in this sense being the high FDI flows amount received by Romania in 2005 and 2006 after a period of six years with significant economical development.

The low-cost workforce was an important aspect that attracted foreign investors to Romania but only in the low-value sectors such as manufacturing, the raise in the salary seen in 2006 and 2007 having as consequence the lowering of the FDI flows in these sectors and the rise in the FDI in the high-value sectors like services where low-cost workforce is not an essential factor but the *skills and qualifications needed for the employees*.

[172] the National Bank of Romania, www.bnro.ro, website visited 06/03/09
[173] European Commission, *Monitoring Report on the state of preparedness for EU membership of Bulgaria and Romania* (2006), p. 5-6 and 9-10 , consulted on http://ec.europa.eu/enlargement/pdf/key_documents/2006/sept/report_bg_ro_2006_en.pdf, website visited 25/05/09

The market size is not a determining factor for the FDI flows in low- value sectors such as manufacturing, where the products of the foreign companies are mainly directed to export[174] and not to internal consumption. It is though an important factor for the high-value sectors such as service, and particularly financial services, the main target for foreign the investors in this field being the Romanian market.

The composition of the top investing countries in Romania accounting for European countries and USA shows the openness of the Romanian economy to Europe and to the world. The economic openness of Romania is also proved by its access to the EU Single Market as an EU member, and thus the elimination of the trade barriers. *Economic openness* is a positive aspect in attracting the foreign investors and its importance for the FDI flows is shown mainly by the top of the investing countries in Romania (the Netherlands, Austria, Germany, France, Italy) that are EU members and participate in the EU Single Market.

The EU integration had and will have implications on factors that directly influence the FDI flows in Romania, like the stage of the reform agenda, trade openness or economic growth. It ca be thus qualified as an important determinant for the FDI flows, its impact on the FDI being indirect.

4.4. FDI Determinants in Romania versus FDI Determinants in SEEC's

Assessing the main FDI determinants in SEEC's according to the FDI theories and the empirical evidence and comparing them to the main findings for Romania, the results are synthesized in the table bellow.

[174] Gabor Hunya, *FDI in South East Europe in 2003-2004* (Vienna : 2004), p. 9, study commissioned by OECD, accessed at http://www.stabilitypact.org/investment/2004,%20FDI%20in%20SEE.pdf, on 20/05/09

Table 4.4.1. – FDI determinant, comparison of the FDI theories and empirical evidence to the case of Romania

FDI determinant	FDI theories and empirical evidence	The case of Romania – own analysis
Economic growth (GDP)	yes	yes
Workforce cost Workforce skills	yes yes	yes – mostly in low-value sectors (manufacturing) yes – mostly in high-value sectors (service)
The transition stage The business environment	yes yes	yes yes –issues like corruption and the judicial apparatus are still obstacles for the foreign investors
Market size	yes	no - mostly for the investors in the low-value sectors that are mainly oriented export oriented (e.g. – the manufacturing sector) yes - mostly for the investors in the high-value sectors that are mainly oriented to the internal market (e.g. - the financial services)
Trade Openness	yes	yes
EU integration	yes	yes – but through indirect factors

Source: own compilation based on the findings from subchapter 3.4 – "FDI Determinants - conclusions" about FDI theories and empirical analysis and subchapter 4.3.5 – "Reform Agenda and the Business Environment - Conclusions" and subchapter 5.2 – "FDI flows in Romania" concerning the results for Romania from own analysis

Note: the mention "yes" means that the corresponding factor has impact on the FDI flows; the mention "no" means that the corresponding factor doesn't have impact on the FDI flows;

The table above shows the report between the results of FDI theories and the empirical evidence and the results in the case of Romania. Except for particular aspects of Romania, the results can be concluded as matching. Small differences are found for factors like *market size*, where there two different trends for Romania, *cost and qualification of the workforce,* where Romania also presents two different trends and *business environment*, where there are still unresolved issues that can negatively influence foreign investors' choice. *The EU integration process* is also an important factor for FDI flows but with indirect influence. In Romania, its influence on the direct FDI determinants (such as the progress of the reform agenda, the economic growth or trade openness), and thus on the FDI, was obvious making it an important FDI determinant.

CONCLUSIONS

Foreign direct investment is an extremely wide spread phenomenon today and it is the direct consequence of technological progress, borders opening, market integration and trade liberalization that offered new ways for economic growth and development by giving the countries the chance to count not only on their national capabilities, natural resources and domestic investors for economic development but also on their neighbor countries or trade partners and on the financial potential of their companies. This was an excellent opportunity for the investors themselves too, that were thus offered the chance to benefit not only from the potential of the domestic market and from the domestic resources like labor force, technology, natural resources, but also from the ones of many other countries, making it possible for them to set a new business or a new branch of their company or to fully relocate their investment where the business environment and resources fitted their needs and interests best.

Due to their multi-folded benefits FDI are of particular importance to transition economies and starting with the fall of the communism in 1990 the transition countries in Central Eastern Europe became extremely interested in attracting foreign investors.

As an ex-communist country Romania matches perfectly the trend among the SEEC's. After 1989 it started the transition process implying many changes and reforms that needed both financial and technological capital. As a consequence, attracting foreign direct investments became an item on the policy agenda of the Romanian authorities.

One of the main targets during the transition process for Romania has been the EU integration. The EU accession negotiations offered the guidelines for the transition process in Romania and most of the reforms implemented had as goal the fulfillment of the engagements Romania took for the EU accession. EU integration had thus a major impact and huge implications on the Romanian society on the whole and particularly on its economy and FDI inflows.

Having as starting point the facts presented above, the aim of this thesis was to find the determinants of the FDI flows received by Romania since 1990 when it started the transition process, to see if they match the pattern for the FDI determinants in the SEEC's, to discover if the EU integration was one of the main determinants of the FDI trend in Romania and if so, to find how the EU integration influenced the FDI flows received by Romania.

The FDI theories offer a brief overview of the main FDI determinants, stating as important to the FDI trend factors like: *ownership*, *location*, *internalization* (the *OLI framework* defined by the Eclectic Paradigm of Dunnings[175]), specific features of the host country like the *economic development* (Markunson[176]) and the *economies of scale*, the *elimination of the customs barriers* as consequences of the Krugman's International Trade Theory[177].

In order to come closer to the case of Romania, **the empirical analysis** about the FDI determinants in the **SEEC's** is very helpful. The empirical results confirm some of the factors stated by the FDI theories like the *economic development*, *the costs and the level of qualification of the labor force in the FDI host country, the market size* and add new ones specific for the SEEC's and mainly determined by their status as transition economies and EU member states or EU candidate countries. These specific factors are: *EU integration*, *the stage of the transition process, the distance between the host and the origin country of the FDI* and *the trade openness.*

Assessing the general trends for the FDI determinants provided by the FDI theories and the more specific empirical results for the FDI determinants in SEEC's, the **FDI determinants in SEEC's** can be sum up as it follows:

- *The economic growth (GDP, GDP per capita)*
- *The costs and the level of qualification of the workforce*
- *The EU enlargement*

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[175] Jones J., Wren C., *op. cit.,* pp. 27-28
[176] Markusen J.R. , Venables A.J., *The Theory of Endowment, Intra-Industry and Multinational Trade* (1996), CEPR Discussion Paper N. 1341, abstract accessed at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=4194, on 14/03/09
[177] Krugman, P. R., *Rethinking International Trade* (1994), accessed at http://books.google.fr/books?id=kR-5nhiJPV0C&printsec=frontcover#PPA16,M1, on 23/04/09

- *The transition stage and the business environment*
- *The market size*
- *Trade openness*
- *The distance between the host and the origin country of the FDI*

As a SEEC, **Romania** matches these countries' profile, being a transition economy and a new EU member state, but it also has its own features and its specific factors determining the FDI flows, such as its **reform agenda for the transition process** and **the trend of the FDI inflows within the economic development** before and after the EU accession.

The reforms implemented during the transition process by the Romanian government are mainly determined by its EU accession engagements and by the major milestones in the EU integration process: in 1993 Romania signed *The Association Agreement with the EU*, the EU accession negotiations were officially opened in 2000 and after a five-years EU negotiations period (2000-2004) Romania signed *the Accession Treaty to the EU* and on the 1st of January 2007 the sixth enlargement of the EU to Romania and Bulgaria took place.

The elements of the **transition process** that had impacts on the FDI flows were mainly the privatization process, the reforming of the business environment and the evolution of the FDI regulatory framework.

Privatization in Romania can be catalogued as slowly and still ongoing, compared to the most successful privatization processes in transition countries. Moving from the public ownership that characterized the Romanian economy during communism to private ownership was one of the requirements exceeded by the EU and thus, the most important privatization periods proved to be 2000-2004, the EU accession negotiation period for Romania, and 2006, the year preceding Romania's EU accession. The privatization process had an important impact on the FDI flows received by Romania and generated the so-called privatization-related FDI.

The main elements of the **business environment** with impact on the foreign investors' activity are: administrative barriers, taxation and not in the end corruption and the judicial system.

In order to lower and eliminate the ***administrative barriers*** against private investors many measures were taken by the Romanian authorities and they went in the right direction, progress stated by the Monitoring Report released by the European Commission in September 2006[178]. They made easier both the process of setting up a new business by completing an on-line application and submitting it on the website of the National Trade Register Office in Romania and the process of conducting a business by helping the SME's and involving the private companies in the decision making process if it concerns their interests. On the 1st of January 2007 the new Fiscal Code aligning Romanian ***taxation*** to the EU standards came into force and through fixing the single flat tax at 16% it made Romania one of the most competitive countries in the region for the foreign investors. Even though many laws and reforms have been implemented by the Romanian government to prevent ***corruption*** and help the ***judicial system***, they remained unresolved issues and significant obstacles for both domestic and foreign investors.

The efforts for improving **the FDI framework** in Romania meant changes at national and at international level. At national level, the changes included the creation of a special governmental body, ARIS, dedicated exclusively to foreign investors and the adoption of the so called "national treatment" for foreign investors, meaning that their treatment in Romania is the same with the treatment of domestic investors'. At international level, Romania signed agreements and commitments and thus it aligned itself with the internationally accepted regulation for FDI, showing *trade and economic openness*. Both national and international efforts made by Romania managed to ease the foreign investors way into the Romanian economy and proved Romania's openness to foreign companies.

Having described the major lines for the transition process in Romania by describing the privatization process, the reforming of the business environment and the FDI framework and by concluding their significant impact on the foreign

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[178] the European Commission, *Monitoring Report on the state of preparedness for EU membership of Bulgaria and Romania* (2006), p. 6 , consulted on http://ec.europa.eu/enlargement/pdf/key_documents/2006/sept/report_bg_ro_2006_en.pdf, website visited 25/05/09

investors' activity, a closer look at **the trend of the FDI inflows within the economic development** before and after the EU accession will contribute to finding the main FDI determinants in Romania and the impact of the EU accession on the FDI flows.

Comparing FDI inflows of Romania to the ones of the neighbor countries and the CEC-5, Romania proved to be the main FDI receiver among the SEEC-8 but it is still behind the main FDI destination countries from the CEC-5 - Poland, the Czech Republic and Hungary - , getting closer to their performances and having a very positive FDI flows evolution during the last 5 years.

Looking from the inside, the FDI flows in Romania had suffered large fluctuations and they were closely related to the country's transformation and restructuring process that had as an aim the EU membership. Romania received most FDI inflows in 2004 and 2006, years that are significant for the privatization process and for its way to the EU membership, fact that made the privatization-related FDI to be dominant within the total amount of FDI received by Romania. The main economy sector that received FDI flows was the industry and particularly manufacturing but starting with 2005-2006 a major shift in the sectoral composition of the FDI flows in Romania could be seen, from low value sectors like manufacturing to high-value sectors like the services, namely the financial services. Most of the investments are concentrated near Bucharest and the main investors come from Europe and they are EU members.

Assessing the brief presentation of the transformation and reforming process in Romania and the analysis of the FDI flows within the Romanian economy, the main **FDI determinants in Romania** can be concluded as the following:

- The *privatization process* as a part of the transition process*:* it influenced the FDI flows through the privatization-related FDI that accounted for a large share within the FDI flows.
- *The economic development*: an example showing its importance for the FDI flows is the high FDI flows amount received by Romania in

2005 and 2006 after a period of six years with significant economical development.

- *The low-cost workforce:* it is an important FDI determinant but only in the low-value sectors such as manufacturing.
- *The qualified workforce:* became important with the increase of the FDI in high-value sectors like services.
- *The market size:* is not a determining factor for the FDI flows in low-value sectors such as manufacturing, the products of the foreign companies being mainly directed to export and not to internal consumption; it is an important factor for the high-value sectors such as service, and particularly financial services, the main target for the foreign investors in this field being the Romanian market.
- *Economic openness*: the first five countries in the investors' top are EU members, fact that can be explained by Romania being an EU member and an EU Single Market member.
- **The *EU integration***: it is an important determinant for the FDI trend in Romania but its influence is indirect and is materialized by its implications on the factors that directly influence the FDI flows in Romania, like the stage of the reform agenda (the privatization process, the administrative barriers and FDI framework), trade openness or economic growth.

Comparing the FDI determinants in Romania and the pattern found for the SEEC's, the conclusion is that except for particular aspects of Romania (*market size*, where there are two different trends for Romania, *cost and qualification of the workforce,* where Romania also presents two different trends and *business environment*, where there are still unresolved issues that can negatively influence foreign investors' choice), the results can be qualified as **matching**.

Concluding, FDI proved significant to Romania that was knocking at EU's door. The way to the EU fitted perfectly to Romania's need to attract foreign investors. **The EU integration** proved an important determinant for the FDI flows in

Romania and the relation between the two elements can be seen as bilateral. On one hand, Romania's way to the EU obliged it to implement reforms that were favorable to the foreign investors. On the other hand, the foreign investors contributed even more to the economic development, helping Romania reach the appropriate parameters requested by the EU membership.

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ANNEXE 1 – FDI flows in Central and Eastern Europe – millions of USD, 1990-2007

Economy / Year	1990	1991	1992	1993	1994	1995	1996	1997	1998
Albania	..	..	20	68	53	70	90	48	45
Bosnia&Herzegovina	_	_	..	..	..	..	..	..	67
Bulgaria	4	56	42	40	105	90	109	505	537
Croatia	_	_	13	144	114	108	493	541	941
Macedonia	_	_	..	..	24	10	11	58	150
Moldova	_	_	17	14	12	67	24	79	76
Romania	0	40	77	94	341	419	263	1215	2031
Serbia&Montenegro	_	_	126	96	63	45	0	740	113
CEEC-8	4	96	294	456	712	809	990	3185	3960
Czech Republic	_	_	_	653	868	2562	1428	1301	3718
Hungary	554	1470	1477	2443	1143	5103	3300	4167	3335
Poland	88	359	678	1715	1875	3659	4498	4908	6365
Slovakia	_	_	_	179	255	2587	370	231	725
Slovenia	_	_	111	113	117	151	174	334	215
CEC-5	642	1829	2266	5103	4259	14062	9769	10942	14358
EU 27	97309	79761	78292	78925	82669	131859	125184	144124	283577

Economy / Year	1999	2000	2001	2002	2003	2004	2005	2006	2007
Albania	41	143	207	135	178	338	262	325	656
Bosnia&Herzegovina	177	146	119	265	381	704	595	708	2022
Bulgaria	819	1002	813	905	2097	3452	3923	7507	8429
Croatia	1452	1110	1582	1100	2049	1079	1788	3423	4925
Macedonia	88	215	447	106	118	323	97	424	320
Moldova	38	128	103	84	74	151	197	242	459
Romania	1027	1057	1158	1141	2196	6436	6483	11366	9774
Serbia&Montenegro	112	50	165	547	1409	1029	2087	5118	3985
CEEC-8	3755	3850	4595	4282	8501	13511	15432	29113	30570
Czech Republic	6324	4986	5641	8483	2101	4974	11658	6013	9123
Hungary	3312	2764	3936	2994	2137	4506	7709	6790	5571
Poland	7270	9343	5714	4131	4589	13091	10363	19198	17580
Slovakia	428	1925	1584	4123	2160	3031	2107	4165	3265
Slovenia	107	136	370	1659	302	831	577	645	1426
CEC-5	17440	19155	17246	21390	11289	26433	32415	36811	36965
EU 27	504491	698148	383945	309386	259422	214342	498400	562444	804290

Source: UNTCAD, www.untcad.org, website visited 21/05/09

ANNEXE 2 – FDI stocks in Central and Eastern Europe – millions of USD, 1990-2007

Economy / Year	1990	1991	1992	1993	1994	1995	1996	1997	1998
Albania	..	..	20	88	141	211	301	349	394
Bosnia&Herzegovina	_	_	..	..	..	..	..	673	740
Bulgaria	112	168	210	250	355	445	554	1059	1597
Croatia	_	_	129	273	388	496	988	2136	1931
Macedonia	_	_	..	..	77	87	98	156	318
Moldova	_	_	16	16	29	97	122	196	254
Romania	0	44	122	215	402	821	1097	2417	4527
Serbia&Montenegro	_	_	..	..	..	..	..	740	853
CEEC-8	112	212	497	842	1392	2157	3161	7725	10613
Czech Republic	_	_	_	3423	4547	7350	8572	9234	14375
Hungary	570	2107	3424	5576	7087	11304	13282	17968	20733
Poland	109	425	1370	2307	3789	7843	11463	14587	22461
Slovakia	_	_	_	642	897	1297	2046	2103	2920
Slovenia	_	_	1819	1931	2048	2617	2730	2207	2777
CEC-5	679	2532	6613	13879	18368	30411	38093	46100	63266
EU 27	760255	838825	847234	879866	997928	1146970	1245097	1281248	1679371

Economy / Year	1999	2000	2001	2002	2003	2004	2005	2006	2007
Albania	435	247	327	360	560	843	1001	1387	2264
Bosnia&Herzegovina	917	1063	1182	1447	1828	2763	2906	3968	5990
Bulgaria	2184	2704	2945	4074	6371	10108	13851	22867	36508
Croatia	2563	2787	3893	6031	8509	12403	14592	27364	44630
Macedonia	362	540	916	1210	1615	2191	2087	2764	3084
Moldova	319	449	549	639	717	869	1056	1300	1813
Romania	5671	6951	8339	7846	12202	20486	25817	45452	60921
Serbia&Montenegro	965	1015	1180	1735	3165	4212	6244	11468	15681
CEEC-8	13415	15756	19331	23343	34968	53875	67554	116570	170890
Czech Republic	17552	21644	27092	38669	45287	57259	60662	79841	101074
Hungary	23260	22870	27407	36224	48340	62585	61970	81586	97397
Poland	26075	34227	41247	48320	57877	86623	90711	124530	142110
Slovakia	3188	4746	5582	8530	14576	20910	23656	38335	40702
Slovenia	2682	2893	2594	4112	6308	7590	7259	8924	10350
CEC-5	72758	86379	103922	135855	172388	234967	244258	333215	391633
EU 27	1840442	2190397	2390830	2897502	3754060	4497904	4512216	5675258	6881625

Source: UNTCAD, www.untcad.org, website visited 21/05/09

ANNEX 3 – FDI stocks per capita in Central and Eastern Europe – millions of USD, 1990-2007

Economy/Year	1990	1991	1992	1993	1994	1995	1996	1997	1998
Albania	..	..	6	27	44	67	96	112	127
Bosnia and Herzegovina	13	19	24	29	42	53	67	129	196
Bulgaria	_	_	..	..	..	..	..	194	207
Croatia	_	_	28	59	83	106	212	462	422
Macedonia	_	_	4	4	7	22	28	45	60
Moldova	_	_	..	..	39	44	50	79	159
Romania	_	_	..	..	..	..	..	68	78
Serbia and Montenegro	0	2	5	9	18	36	49	108	203
CEEC-8	6	11	13	26	39	55	84	150	182
Czech Republic	_	_	_	332	441	713	833	898	1401
Hungary	55	204	331	539	686	1094	1288	1746	2019
Poland	3	11	36	60	98	203	297	378	583
Slovakia	_	_	_	120	168	242	381	391	542
Slovenia	_	_	936	990	1046	1332	1386	1118	1405
CEC-5	29	107	434	408	488	717	837	906	1190
EU 27	1642	1805	1780	1842	2084	2389	2589	2660	3482

Economy/Year	1999	2000	2001	2002	2003	2004	2005	2006	2007
Albania	141	80	106	116	180	269	318	437	710
Bosnia and Herzegovina	271	338	371	516	812	1297	1788	2973	4779
Bulgaria	248	281	307	373	469	708	742	1011	1522
Croatia	566	619	865	1339	1882	2732	3206	6006	9797
Macedonia	76	108	134	159	180	221	273	339	478
Moldova	181	269	454	598	797	1079	1026	1357	1513
Romania	89	94	110	163	299	400	596	1097	1500
Serbia and Montenegro	255	314	378	358	559	943	1194	2111	2842
CEEC-8	228	263	341	453	647	956	1143	1916	2893
Czech Republic	1715	2118	2654	3790	4441	5617	5952	7836	9923
Hungary	2271	2239	2690	3564	4768	6188	6144	8111	9711
Poland	678	891	1075	1260	1511	2265	2375	3265	3732
Slovakia	592	881	1036	1583	2706	3882	4391	7115	7551
Slovenia	1355	1458	1305	2066	3163	3800	3631	4460	5171
CEC-5	1322	1517	1752	2453	3318	4350	4499	6157	7217
EU 27	3810	4525	4924	5947	7675	9162	9162	11493	13904

Source: UNTCAD, www.untcad.org, website visited 21/05/09

ANNEX 4 – FDI stocks as % of GDP in Central and Eastern Europe – millions of USD, 1990-2007

Country/Year	1990	1991	1992	1993	1994	1995	1996	1997	1998
Albania	..	..	1	5	7	9	9	15	14
Bosnia and Herzegovina	_	_	..	..	..	..	..	18	17
Bulgaria	1	2	2	2	4	3	6	10	13
Croatia	_	_	1	3	3	3	5	11	9
Macedonia	_	_	..	..	2	2	2	4	9
Moldova	_	_	1	1	2	6	7	10	15
Romania	0	0	1	1	1	2	3	7	11
Serbia and Montenegro	_	_	..	..	..	..	..	3	4
CEEC-8	0	1	1	2	3	4	5	10	11
Czech Republic	_	_	_	9	10	13	14	16	23
Hungary	2	6	9	14	17	25	29	38	43
Poland	0	1	1	2	3	6	7	9	13
Slovakia	_	_	_	5	6	7	10	10	13
Slovenia	_	_	15	15	14	13	13	11	13
CEC-5	1	3	8	9	10	13	15	17	21
EU 27	10	11	10	12	13	13	13	15	18

Country/Year	1999	2000	2001	2002	2003	2004	2005	2006	2007
Albania	12	7	8	8	10	11	12	16	22
Bosnia and Herzegovina	20	21	22	23	24	30	29	35	44
Bulgaria	17	21	22	26	32	41	51	71	91
Croatia	13	15	20	26	29	35	38	65	88
Macedonia	10	15	27	32	35	41	36	44	41
Moldova	27	35	37	38	36	33	35	39	44
Romania	16	19	21	17	21	27	26	37	37
Serbia and Montenegro	8	9	9	9	13	15	25	33	34
CEEC-8	15	18	21	23	25	29	32	42	50
Czech Republic	29	38	44	51	50	53	49	57	58
Hungary	47	48	51	54	57	61	56	73	71
Poland	16	20	22	24	27	34	30	37	34
Slovakia	15	23	26	35	44	50	50	68	54
Slovenia	12	15	13	18	22	23	21	24	23
CEC-5	24	29	31	37	40	44	41	52	48
EU 27	20	26	28	31	33	34	33	39	41

Source: UNTCAD, www.untcad.org, website visited 21/05/09