FOREIGN DIRECT INVESTMENTS AND REGIONAL DEVELOPMENT IN ROMANIA

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After the year 2000, as business was improving and the flat tax was introduced, the positive perception of Romania by partners has attracted major capital flows in the national economy. Although industry is unanimously considered to be a major source of economic and social imbalance, yet in time it has proved to be by far more attractive to foreign investors than agriculture and tourism, which have a remarkable potential in this country. Major foreign investments are located in the main urban centres, because they are more easily accessible and more open to establishing relations and have a more dynamic economic milieu. Bucharest continues to hold a dominant position, either by hosting foreign companies, or simply their headquarters. Next come the regional capitals, basically cities with more than 300,000 inhabitants, with a large sphere of influence and capacity of coordinating the regional economic space. Moreover, present evolutions have shown that Romania is likely to loose its cheap labour advantage, a situation that makes its further attractiveness for international investment flows really questionable.

MACRO-ECONOMIC BACKGROUND

Like many East European countries, formerly in the Soviet sphere of influence, Romania has been striving to change the command economy for the market system. Successive governments found it difficult to transform the economy because of a shortage of hard currency and failure to ensure foreign funding given the significant budget deficits generated largely by money-losing state industries. The old economic and financial structures, just as the bureaucratic culture inherited by many institutions were slow in changing. It is only within recent years that the general business climate has been improving and economic indicators look better.

In the 1990s, classifications of the hierarchy of former socialist countries in terms of foreign direct investments, placed Romania close to the bottom of the table. The national strategy of short-term economic development published in 2000, estimated (p. 42) that “the volume of foreign investment flows is rather limited”, “Romania being one of the states in transition with the poorest performances” in this domain (calculated per capita, the bulk of foreign direct investment at the end of 1999 was about 240 Euros versus 1,900 in Hungary and 1,500 in the Czech Republic). In the beginning, this foreign investment was an issue as sensitive as privatization, having in view legislative instability, a very developed bureaucratic system, a less attractive business milieu, and fewer facilities offered to investors than in other Central and East-European countries. Privatisation of large-scale industry led as a rule to the reduction in the number of jobs and increase of unemployment, while the new sector of SMEs generated the majority of the new jobs (Isaic-Maniu, 2008). Fuelled by large privatisation programmes, foreign investors were attracted by Romania’s relatively low unit labour cost, proximity to the euro area, sound macroeconomic fundamentals and its already increasing domestic market potential (Pauwels and Ioniță, 2008). However, the boom of privatisation-led FDI, which represented about half of the FDI inflows in the 1990s, is now largely over.

From the early 2000 onward, Romania relaxed its FDI policies by treating equally domestic and foreign firms in respect to free the transfer of income abroad. Consequently, the past few years

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witnessed an improvement of the business climate, as beneficial effects of the flat tax and of a positive attitude of foreign investors towards Romania have drawn major capital flows in the economy. The investors' perception has also changed as the US State Department assigned Romania the market economy status in 2003, and Fitch Agency upgraded its rating to "investment grade"; similarly, Standard and Poor's and Moody's scores were improved. Therefore, FDI flows have increased, placing Romania on the second place in 2006 between the countries of Central and Eastern Europe. This catching-up process accelerated from 2004 with net inward FDI flows as a share of GDP exceeding the inflows recorded in both the eight Central and Eastern European countries which joined the EU in 2004 and the EU-15 (Pauwels and Ioniță 2008). The largest single beneficiary in terms of FDI stocks remains the manufacturing sector, which held more than 1/3 of the inward investments in 2006. While FDI stocks in this sector, as a share of GDP, increased overall between 2003 and 2006, they have also undergone major reallocations within the sector (Pauwels and Ioniță 2008). FDI has decreased in the lower-end of the value chain (textiles and leather), while it has increased in higher value-added sectors (transport equipment – motor vehicles and shipping). Obviously, there is a positive correlation between FDI and economic growth, in general (Pauna and Dumitrescu 2005; Pelinescu and Rădulescu 2009) and manufacturing increase, in particular. Besides many TNCs location, the country has witnessed lately a high birth rate of domestic manufacturing firms which, together with the relatively stable employment and increasing shares at total exports, shows significant gains of productivity and competitiveness. Industrial production growth rate has recorded positive values all along the 2000s, culminating with a two-digit figure in 2008 (10.6%) (CIA World Factbook).

FDI IN THE ROMANIAN ECONOMY. EVOLUTIONS

The year 2006 represented an absolute record for foreign direct investment (9.1 billion Euros) in this country, the FDI volume increasing by 75% compared to 2005. A recent study made by Ernst and Young Consultancy Company listed Romania as the most attractive investment destination in South-Eastern Europe. And indeed, that same year (2006) Romania ranked second in Central and Eastern Europe, after Poland, but by far before Hungary, the Czech Republic, Bulgaria, Slovakia and Slovenia. This upsurge reflects in the significant numerical growth of joint ventures (nearly 10% in 2006 versus 2005) and moreover in the 165% growth rate of social capital subscribed in 2006 compared with the preceding year. A favourable and stable macro-economic context and attractive business milieu account for the accelerated FDI growth rate of 35% in the first semester of 2008 as against the same period in 2005. The volume of vested capital over January-June 2008 was by 4.75 billion Euros bigger than the 3.5 billion Euros placed in the first semester of 2007. Referring to the 1.2 billion invested in the first six months of 2004, 2008 figures are four-times higher. In view of it, Romania's position of leader in attracting FDI in South-Eastern Europe is being maintained and strengthened, since investment flows forecast for this region exceed 8 billion Euros. In the first semester of 2008, Romania succeeded in attracting two-thirds of the annual regional estimates.

The difference between the numerical growth of companies and the capital they possessed suggests the areas that benefitted from major investments. Thus, in the 1990s, foreign direct investments promoted a prudent policy, therefore trading companies became a preferential option, because they required little capital and developed activities which secured fast recovery rates of vested capital. Thus, in the structure of foreign investment, commercial activity proved more attractive and less risky. The investments made over the past few years had a major impact on the economy, given the comparative advantages offered by the financial banking and industrial sectors. Industry was indeed a choice sector for foreign investors, Romania having important energy resources and good agricultural lands. But for all their development potential they are still little exploited, for example agriculture and tourism. The technological sector has a well-trained, relatively cheap labour force which makes it economically attractive. Good opportunities for progress had also the housing sector. Foreign investors showed an overriding interest in oil, natural gas, the car industry, iron and steel industry, banks and financial sector, food industry, telecommunications, constructions and consumer goods. In 2007, interests focused on car-making, electronics, electrotechnics, constructions, farm products and bio-diesel production. It should be remembered that Romania has an old car-making tradition and electronics and electrotechnics have a skilled available labour force. Constructions profited from the housing market boom, while bio-diesel crops are grown on large areas. A qualified workforce in information technology and communication was an important asset for directing big investment fluxes to these sectors. Speaking of spatial FDI locations the option is for large cities boasting economic diversity, easy access, potentially developing relations and an attractive and dynamic economic milieu. No wonder that Bucharest holds two thirds of the total vested capital and one third of greenfield investments. Next to Bucharest stand other three counties: Timiş – SolPlus from Japan plastics; Umeltechnic from Austria building materials; and Willy Kreutz from Germany electronic parts. Argeş and Galați have each a major investment in industry: Renault Group Dacia (car-making) and ArcelorMittal (metallurgy), respectively. Foreign Direct Investment follows the south-east north-west axis of leading industrialized counties, running from Prahova and Braşov to Mureş, Cluj and Bihor and further to Bacău, the outstanding industrial county in Moldova and Constanța, easily accessible to maritime transport.

FOREIGN DIRECT INVESTMENT IN INDUSTRY

Investment fluxes in the Romanian industry followed the same pattern, from hesitant to consolidated. Although unanimously perceived as a major source of economic and social imbalance, industry has long proved to be more attractive to foreign investors than agriculture and tourism which have a remarkable development potential in Romania. The process of deindustrialization is visible in the 24.6% of the overall population employed in this sector and 24.2% contribution to GDP. In the early 1990s, Romania held position 20 worldwide in respect to industrial added value according to UNIDO (United Nations Industrial Development Organisation). In mid-1990s industry still employed one third of the labour force and generated 40% of GDP. And, yet, in 1996, only 0.5% of all joint ventures are active in this sector and with modest capital amounts too, mainly in electronics and electrotechnics, chemical products, machine-building, food industry and wood processing, while textiles and ready-mades had hardly any interest to foreign investors (Fig. 1a, 1b).

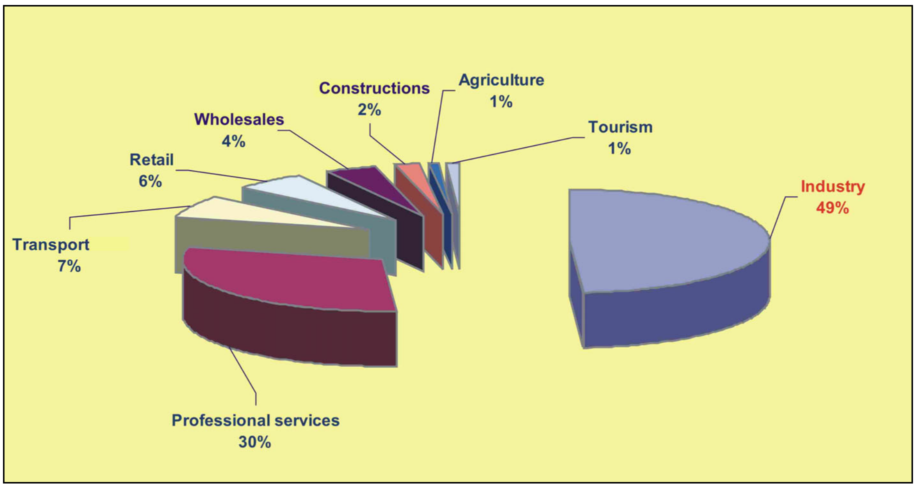

Fig. 1a – FDI by number of companies and economic sectors, 1991–2007.

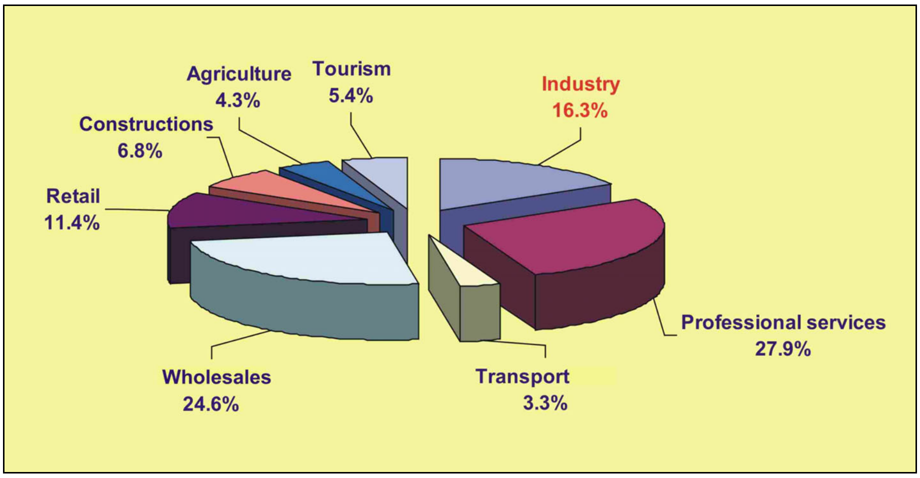

Fig. 1b – FDI by the amount of subscribed capital an economic sectors, 1991–2007.

Structural difficulties, outdated production infrastructure, loss of the traditional COMECOM market, low productivity, high raw material and energy consumption were drawbacks that made foreign investors cautious. Most industrial investments were brownfields which, according to the National Bank of Romania, represent money invested in enterprises taken over fully or partly by investors, over 50% of corporative and non-corporative assets occurring after the take over. Two characteristics can be distinguished. In the first place, excepting Bucharest, no important investments in the industry of other large cities were made despite their having a complex and diversified economy. The main reason for investing being the industrial specialization level, it was small and middle towns that were the beneficiaries, e.g. Salonta and Haţeg (food industry), Vaşcău and Măcin (building materials), Oneşti and Mărăşeşti (chemical industry), Oţelu Rosu (metallurgy), Orăştie and Negreşti Oaş (ready-mades), Găeşti and Fieni (electrotechnics), Beiuş and Comăneşti (wood processing). A second characteristic besides spatial location was the impact of joint ventures on the functionality of and potential effects for the other components of the industrial system. As a matter of fact, few of the new ventures had a significant impact on the organization, functionality and performance of Romanian partners because of limited cooperation relations and little vertical integration into the industrial production system and, besides, more often than not, these companies employed a cheap labour force and used mainly the existing facilities. However, over the past few years, it appears that industry has become more investment-attractive, representing around 50% in all, the evolution of foreign direct participation acquiring new characteristics versus the 1990s.

Firstly, a change in the sectoral structure of these investments in that two of the branches, metallurgy and chemical products, considered totally unattractive in previous years, proved to be most profitable for investors. Another eligible investment was the food industry, rich in resources and with a large consumption market. Other two sectors, transport means and building materials, outran the former promising textiles and ready-mades industries, and even wood-processing.

Secondly, a new location pattern emerged, namely the large urban centres which offered better access, relations and a more dynamic economic milieu. Bucharest continued to be a dominant investment location, hosting either foreign companies or their headquarters. Next in line came the regional capitals with over 300,000 inhabitants, spheres of influence and capacity to co-ordinate the regional economic space.

Thirdly, greenfield investments were ever more numerous, that is investments in enterprises set up and developed by foreign investors or jointly with Romanian partners starting from nought. This investment type represents some 15% of total, brownfield ones and take over being still the dominant type. Major greenfield investments went to the food industry, textiles and garments, transport means, crude oil and wood processing.

LOCATION FACTORS OF INDUSTRIAL FOREIGN INVESTMENTS

Location factors proved relatively constant in time. For example, the labour force laid off from the state sector is cheaper than in the investor's country of origin, but skilled and moreover not so much syndicalised as in other parts of the world. Cheap labour has initially been a determinant factor for localizing and directing capital flows. Illustrative in this respect is the ready-mades industry, investments made in the early 1990s promoting the lohn system. Perceived as short-term development opportunity, the lohn system was later criticized for using exclusively cheap labour and failing to have positive effects on the economic growth. Currently, although lohn production companies are still important, supplying 24% of exported items, their contribution to depleting open account deficit tends to decrease. This is explainable by the negative export dynamics of these companies over the past years (by 23.1% in 2005 and 9.6% in the first half of 2006, versus increases in the economy, generally. Cheap labour is still a basic factor for multi-national companies to invest, however, qualification and specialization are becoming ever more important. EMEA Microsoft set up in Bucharest an administrative centre for technical support which provides 750 new jobs for specialists in engineering, electronics, computer science, physics, management and fluent knowledge of English, French and German. The Centre is destined to serve corporative clients from Germany, France and Great Britain. General Electric has opened up a centre of technological solutions and business services for companies in banking-financing-accountancy, IT management, insurance, logistics and engineering. Hewlett-Packard's centre addresses the businesses of partners from Europe, Middle East and Africa.

Another attractive investment location factor is a more permissive industrial and environmental policy, because legal regulations which are indeed in line with EU provisions, are more loosely applied. An example would be the building materials industry in which three firms have monopolized the cement market. In 2005, the Agency for Consummers' Protection accused them of overlooking free competition by agreeing jointly to set selling prices. Lafarge Group (French capital), bought the cement factories at Medgidia, Hoghiz and Târgu Jiu; CarpatCement Holding (Dutch capital) those at Fieni, Bicaz and Deva (Chiscadaga); and Holcim (Swiss capital) bought cement factories in Aleşd, Turda and Câmpulung. Another example is the tobacco industry which has an important market, yet setting regulations in conformity with EU standards is still being postponed. The main foreign investor, Galaxy Tobacco, (Italian capital) holds the majority of factories in Arad, Râmnicu Sarat, Sfântu Gheorghe, Craiova, Târgu Jiu, Timişoara and Bârlad. There are three more multinational companies in this branch: Philip Morris, British-American Tobacco and JT Romania. The same lack of regulations explains the attractiveness of FDI for iron and steel and aluminum industries, ArcelorMittal Steel Galați and Alro Slatina which have become the biggest steel and aluminum producers in Central and Eastern Europe.

Also an interesting location factor over the past few years have been the industrial parks which have succeeded in drawing investment fluxes. The industrial park concept was legally defined by regulations issued between 2001–2003, stipulating fiscal facilities to support the revitalization of abandoned or underused brownfield industrial spaces in partly or fully developed urban areas. In 2000, the Ministry of Environment reported 900 thousand hectares classified as brownfields, yet without any detail on the number or geographical location of those areas. An empiric approach suggests that most brownfield sites exist in several of Romania's industrial towns, irrespective of their demographic size or present functionality. So far now, Ploieşti Industrial Park has proved attractive to Japanese company Yazaki (electric wiring for vehicles) and Kansei (air-conditioned units and cooling systems), as well as the American firm Johnson Central (car interiors). Sibiu Industrial Park benefits at least from three major investments: the Austrian Wienerberger tile producer, the Spanish Caucho Metal Productos (antivibration parts for the car industry) and the German firm Marquardt Schaltsysteme (electronic parts for vehicles).

Many foreign investments are located in urban agglomerations that influence inter-company relations and transaction costs offering interdependence advantages, such as flexibility, minimization of risk and specialization. Unless geographical proximity exists, advantages would be nill, because of higher costs and transactioning difficulties. The advantages of agglomerations materialize in external savings since flexibility depletes input costs and increases output ones, so that the more numerous input-output connections, the greater the probability for successful sales. Once established, agglomerations constitute industrial communities producing endogenous dynamics for know-how and technology to develop. That explains why investments are concentrated in certain places, many of them in industrial parks or in the proximity of major investors. Another factor worth considering by FDI spatial strategy is the business milieu, represented by a system of regional institutions, rules and practices conducive to innovations. The input-output network is rooted in a setting supplying network members with everything necessary for successful coordination, adaptation or innovation. The setting emerges as a socio-economic creation that generates economic growth, it is the framework that pushes dynamics into motion. The local setting appears to be the determinant element in the companies' choice of large towns, or of Bucharest capital-city.

There are numerous examples of the multi-nationals' stagewise spatial strategy in Romania. The complex organizational structures peculiar to these companies are beginning to take shape, some companies having concluded licencing agreements with a local firm to have access to the local market, others opening up commercial representation addressed to foreign markets. Other multi-national firms are in a more advanced stage, acquiring a native firm that has a privileged position in the domestic market or is engaged in important export activities. Some others strengthen internationalized production by setting up fresh production units in new sites, or by taking control of the firm with which they had had initially signed a licencing agreement. And last, but not least, there are multi-nationals in the final stage, that of reorganization or rationalization of the production network. Rationalisation means closing down some production units, dislodgings and relocations, eventually pooling some production facilities to supply domestic or international markets. The result of reorganizing the production system is enhanced by vertical integration by specializing production units from various countries in terms of specific stages of the manufacturing process and shifting assembling operations only to one of these countries. There are multinationals that promote a strategy of spatial functional disassociation separating coordination and control in the headquarters, situated in or close to a major urban centre, assigning distribution, retail and marketing to easily accessible regional poles that have a positive influence on regional markets placing production activities in the proximity of resources and labour. It is the case of multinationals with social offices in Bucharest and manufacturing networks in small and middle towns. Two types of industrialization are being promoted by the foreign companies: diffuse industrialization, including activities in which labour costs hold an important share in total production costs. Reducing labour costs by technological change is not a priority. This type of industrialization targets the countryside which is an attractive setting of cheaper workforce, local resources, lower planting costs and taxes, less syndicalism and good access: wood processing at Buchin, machine building at Cristian and Brănești, and building materials at Gura Ocniței. Subsidiary-based industrialization requires significant inputs of technology, skilled labour force and centrality to procure and distribute raw materials and assemble finished products. This is the preferred form of industry located in towns of various demographic size and development potential.

The Romanian Agency for Foreign Investment (ARIS) classified foreign investments in terms of the social capital subscribed in 2006 (data supplied by the National Office of Trade Register). Out of the 100 firms, 55 operate in the industrial sector. Between 2004 and 2006, ARIS monitored 62 investment projects totaling 2.9 billion Euro, scheduled to create 33,105 jobs by the end of that year, 46 of them in industry. Foreign investments in the car industry are of consequence both by the number and volume of vested capital and by their impact on regional manufacturing systems. Japanese and American firms located in the above mentioned industrial parks, together with an Italian investor in Turda, a German one in Satu Mare, or the car envelop producers Michelin in Zalău and Pirelli in

Slatina. A more recent investment from the Spanish group Bamesa and the multinational Arcelor has materialized in a services centre for car steel items opened at Topoloveni in the proximity of Renault, the main car producer in this country.

FOREIGN DIRECT INVESTMENTS AND REGIONAL DEVELOPMENT

The FDI location patterns contributes to a new geography of the Romanian industry, also developing various methods of industrialization, engendering sectors and locations along diverging growth trajectories, changing all established contexts. Concentrated in certain places, FDI resorts to various modalities for the development of industry which, spatially speaking, are connected to the regions' industrial history, the present being but a reflection of the past. Therefore, past choices, technologies visible in production infrastructure and product design, the companies' capital basically licences and specific competences, or training-related labour specialization do influence further selection of methods, products and practices. This type of evolution is by no means a rigid one relying simply on technology and past developments but rather a road map depicting the agreed direction capable to lead onto the right way at a faster pace where radical changes are difficult to make. This rationale works also in the case of industrial location and FDI geographical strategy makes no exception either, which explains why better industrialized regions are the chosen ones. Foreign companies are beginning to be increasingly closer to the local and regional economies, developing relations with competitors, customers, suppliers, regional business organizations and public forums. It is essential for these companies to have interests and goals in common with other industrial or regional actors, such as trade unions, suppliers of business services, commercial associations and officials in regional development problems. The companies' geographical strategies have been assessed empirically in order to outline the character and strength of the regional economies hosting them. A good example in this respect is the vertical integration of the car industry. Renault Dacia, the main car producer in Romania, went beyond developing up and downstream production relations and forming some manufacturing networks for car parts, components and equipments. The location of the firm induced also companies from Germany, US, Japan, Spain and Italy to invest in urban centres like Ploieşti, Sibiu, Turda, Satu Mare, Zalău, Slatina and Topoloveni. Besides, Renault Dacia Group opened a technological centre at Titu for testing vehicles and mechanical parts designed in the Groups' offices. The project, estimated at 450 million Euro, will employ over 3,000 engineers to develop new products. In Bucharest, the company set up Renault Design Central Europe, the first car design centre in this country conceived to have a say in car-making projects from beginning to end; the aim is to integrate Romania in every phase, from design and conception to engineering and manufacturing a vehicle. Regional performance often depends on the behavior and the dynamics of firms and of key industries; regional dynamics is tributary to the export-oriented companies. One of the factors which make regional development a success is the deep-going implication of the multinational firm in the respective regions. Many companies are certainly attracted by regions that have specialized and renowned industries and products. No wonder therefore that major investments are missing from the north-east and south regions classified among the poorest in Romania (Fig. 2).

THE ECONOMIC CRISIS AND FOREIGN DIRECT INVESTMENT

In periods of economic growth, the positive impact of foreign companies is obvious, but the economic crisis that set by the end of 2008 had a negative effect on these companies. People use to talk already about the difficulties facing the banking sector in Romania, or the foreign firms engaged in industrial activities. Even Renault Dacia, the national producer, closed down some production sectors during the late 2008 and 2010. As a matter of fact, forecasts for 2010 drew an alarm bell, warning that around 100,000 people would lose their jobs, one fifth of them working with major companies which until the end of 2010 were to lay off some 7% of their employees. According to estimates the first 20 private companies have been most severely hit. The majority of employees (3,000) were made redundant by Petrom Company, thus raising the number of lay-offs after privatization to 10,370 out of the 13,700 working on the iron and steel platform after 2008. The German group Draxlmaier, the main employer in the local car industry, dismissed 800 people from three of its factories, that is less than 5%of all its employees. Other big companies that have announced personnel cuts are Kraft Foods, Alro Slatina, Otelinox Târgovişte, and Oltchim Râmnicu Vâlcea. A similar situation has been facing the large state companies, where almost 2,500 employees are to be made redundant, many from Electrica, supplier and distributor of state-owned electric power. The wave of redundancies affected primarily the counties of Cluj, Braşov, Galați, and Prahova, which are some of the most industrialized counties. Moreover, Nokia Company located in Cluj County, decided to close down and leave so that about 2,000 people remained jobless. This decision suggests that Romania is expected to lose its comparative advantage of cheap labour, a reality that questions further attractiveness of the Romanian economy for foreign investments.

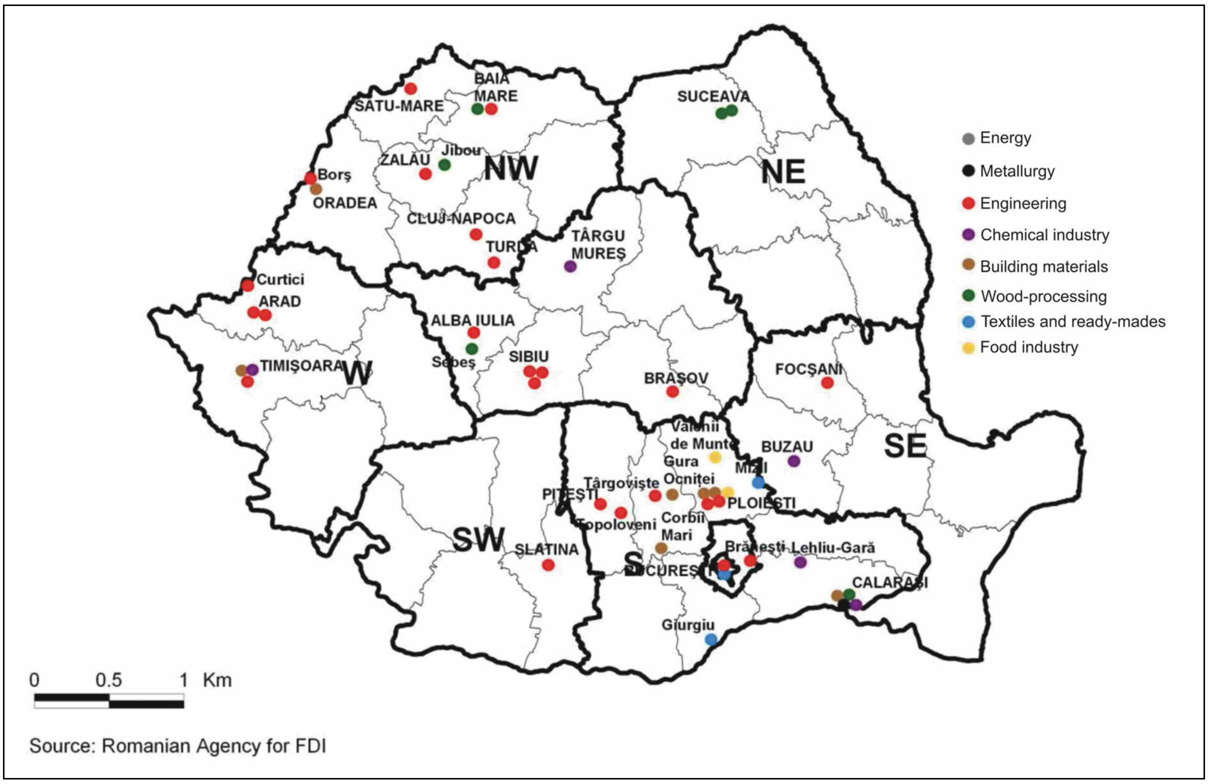

Fig. 2 – Foreign Direct Investments in industry (Major Projects) (2004–2006).

Manufacturing is the major attraction for FDI: the total shares have varied from more than half in the early 2000s (50.9% in 2003) to about one third at the end of the decade (31.3% in 2008). FDI played a significant role in changing industry concentration patterns inherited from the centrally-planned period. These changes seem to go in the direction of a less concentration, as indicated by the negative sign of the initial share variable (Resmini 2000). Although the capital city remains the major recipient of FDI during the 1990s, the concentration of FDI has increased in all locations, thus indicating patterns of dispersion of foreign firms across regions in recent years.

Increasing specialisation is predicted as a result of trade liberalisation and economic integration. It has been claimed that the processes of internationalisation and structural change in transition economies tend to favour metropolitan and western regions, as well as regions with strong industrial base (Trăistaru *et al.* 2002; Petrakos 1996). The analysis of the foreign trade of Romania especially with the EU, revealed a long term „specialisation" as a supplier of labor and energy-intensive-low-value-added products, although the technology-intensive products gained higher shares in recent years (Chilian 2009). Consequently, Romania's patterns of FDI and foreign trade clearly show a transition from a competitive advantage in the lower-end of the value chain (in particular textiles and leather) towards a higher value-added manufacturing sub-sectors (Pauwels and Ioniță 2008). All along the 2000s, the country has experienced the largest FDI inflows and has also witnessed the largest increase in skilled-labor and capital-intensive exports. More recently, Romania's low-cost advantage is gradually eroded in certain sectors, facing increasing competition from Asian economies in clothing and leather, and, recently, in IT industries

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