Foreign Direct Investments and the Economic Crisis in Romania

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Abstract:
The article analyzes the impact of the economic and financial crisis on foreign direct investments flows by trying to explain in the beginning the causes of the current sub-prime crisis that started in the US through a chronological presentation of the events that took place on the international arena. Afterwards, the focus of the analysis restrains to the case of Romania: main investors in Romania, economic sectors that received most of the foreign direct investments, industries where new jobs were created, companies with foreign shareholders established.
On the short run, it is considered that the negative impact of the global economic and financial crisis on the global flow of foreign direct investments will remain dominant, contributing thus to its continuous decrease in 2009, with the mention that decreases will be recorded at all levels. Still, some factors like investment opportunities given by the reduced asset prices and industrial restructuring, the existence of financial resources in emergent economies and petrol exporting countries, the rapid expansion of new activities such as unconventional energy resources could contribute to the revitalization of the international investments flows.

Keywords: foreign direct investments, economic and financial crisis, investment flows, global financial market

JEL Classification: G15, G19

1. The Global Economic Crisis – from the Subprime Crisis to the Crisis of Central and Eastern Europe States' Economies

The subprime crisis does not have its origins in the complex financial system of the 21st century, but, in a paradoxical way, it draws its origins from the government ruling of the American president Ronald Reagan and the British Prime Minister Margaret Thatcher. Forasmuch as they counted on the market self-regulatory capacity, the two political leaders have militated for the reduction of the restrictions imposed on the financial market, which led to the uncontrolled explosion of credit. Such an approach represented the basis of the current crisis, as investors and banks undertook huge risks without any constraint.

The main cause that led to the escalation of turbulences was the lack of the banking system's surveillance. According to the opinion of the American investor George Soros, the subprime crisis is "a crisis made by man's hand and due to a wrong belief that gravitates around the idea that the market has the capacity to its correct own excesses by itself". He also considers that a long period of time will pass till the effects of real-estate market decline will be felt at full intensity [Hegalson, 2008, pg. 97].

It is important to underline that since the market is made of millions of individuals that act inside, it cannot be dominated except by the uncertainty caused by human relations, translated to the existence of the phenomenon of information asymmetry. Thus, market deviations are the result of the interaction between two opposed elements: the wrong perceptions of people and the existent reality. For instance, during the real-estate boom from the United States a reality existed: low interest rates and the possibility to take a loan very easily. On the other hand, there was also the wrong perception of consumers that thought real-estate prices would continue to increase without being affected by the low interest rates [Ammann, 2005].

The deviation of the mortgage market and implicitly of the real-estate market appeared at the moment when the wrong perception of people fueled an explosion that eventually could not be sustained. The belief according to which the market corrects itself is completely wrong, considering the cases of previous crises that have almost destabilized the financial system, and which could not be solved without the dynamic intervention of the authorities, and not by market corrections [Băcescu, 1999].

In the last years, people on Wall Street proved to be very creative when it comes to ways to convert credit into bonds that could be sold to investors avid for high returns. And the culminant point of these measures was represented by the subprime credits – meaning those financial assets created by “bundling” credits given to people with questionable credit worthiness and that involved a high degree of risk [Bejenaru, 2004].

Now, given the crisis of the American financial system, investors are not willing to undertake any risk, becoming unwilling to pay even for the market price of financial instruments guaranteed by mortgages, and being afraid that debtors might enter the impossibility to reimburse their credits. Such a situation determines banks’ reticence to give credits, hardening lending conditions and bringing more and more consumers to a difficult condition.

Banks and brokerage companies have already significantly reduced the accounting assets represented by the financial instruments based on subprime credits, due to the record number of bad debtors. Moreover, there is no sign to show that the decline of the real-estate market is close to its end, a fact that increases more and more the uncertainties regarding the total value of the bad debts. “The only viable solution for solving the crisis of the real-estate market would be the increase in the prices of properties”, said Jeffrey Gundlach, the investment director of TCW Group [Nistor, 2008, pg.85].

Under these circumstances, the most important activity of a Wall Street company could not be other than the concern for its own survival. And thus, financial institutions become more and more reticent to give inter-banking loans, such an operation being possible only in the case of the non-existence of a single doubt the borrower has the capacity to reimburse the loan.

Moreover, the bankruptcy is almost “ensured” once the rumors about the difficult situation of a company hit the market. For instance, in January 2007 – immediately after the launch of the speculations on the liquidity crisis of Countrywide, the biggest American mortgage lender, the institution agreed to become part of Bank of America’s portfolio [Scott, 2008].

Considering the high degree of integration of the capital markets at a global level, it was obvious that the shocks of the subprime crisis were about to be felt globally at short notice. Among the first hit by the financial crisis were the Europeans, due to the investments made by large corporations on the American secondary capital market [Isărescu, 2009]. Thus, the turbulences on the global financial markets started in the summer of 2007, when the shares of two investment funds of BNP Paribas were suspended from transaction, due to the accumulation of bad debts.

The problem raised by the lack of liquidities some banks started to confront with degenerated into a liquidity crisis when more and more banks began to refuse to lend to other banks, being afraid of not recovering their money. The liquidity crisis extended from America to Europe, and gradually to all large financial markets, so as to hit immediately after the real economy at a global level [Stratfor, 2008].

The global economy is now confronted with the worst economic and financial crisis since the Great Depression of 80 years ago, and governments make massive efforts to sustain the markets, when the biggest economies of the world entered recession. The evolution of this situation is marked, gradually at first, by bankruptcies and nationalizations. Thus, on February 17th 2008 the British bank Northern Rock was nationalized, and after that, on March 16th the bank JPMorgan Chase & Co bought the investment bank Bear Stearns at a very low price, with the help of the American central bank. In the meantime, on March 11th central banks worldwide made a new massive liquidity injection on the credit markets. On September 15th, Lehman Brothers – at that time the fourth investment bank in the world – went bankrupt, and Merrill Lynch – the third investment bank in the world – was taken over by Bank of America. Ten international banks created a liquidity fund of 70 billion US dollars to use in emergency situations, while central banks relaxed credit conditions. Nevertheless, these measures could not stop significant falls on the international capital markets [Popa, 2009].

On September 16th 2008, the American central bank – FED (Federal Reserve) and the American government began the nationalization of the biggest insurance group worldwide, American International Group (AIG) threatened by bankruptcy, and agreed to help by providing 85 billion US dollars in exchange of 79.9% of their shares, but the second day the international capital markets started to fall, and central banks began to take more and more measures to bring liquidity on the financial market [Stratfor, 2009].

In their turn, governments worldwide initiated more actions to save financial markets, strongly interrelated. Thus, on October 3rd 2008, the American Congress adopted a rescue plan for the banking system of 700 billion euro and, the second day in Paris, a mini-summit of the four most important European countries was held to find new solutions for the ongoing crisis. On October 8th, the British Government adopted a rescue plan for the banking system, and the most important central banks in the world took joint decisions to relax their monetary policies. Still, on October 10th, the majority of the world stock exchanges were confronted with significant drops. On October 12th, Eurogroup representatives reached an agreement for action that mentioned guarantees for the inter-banking loans, banks' recapitalizations, whereas the second day Paris, Berlin, Madrid, Vienna and other European capitals presented their plans for the rescue of the banking system [Stratfor, 2008].

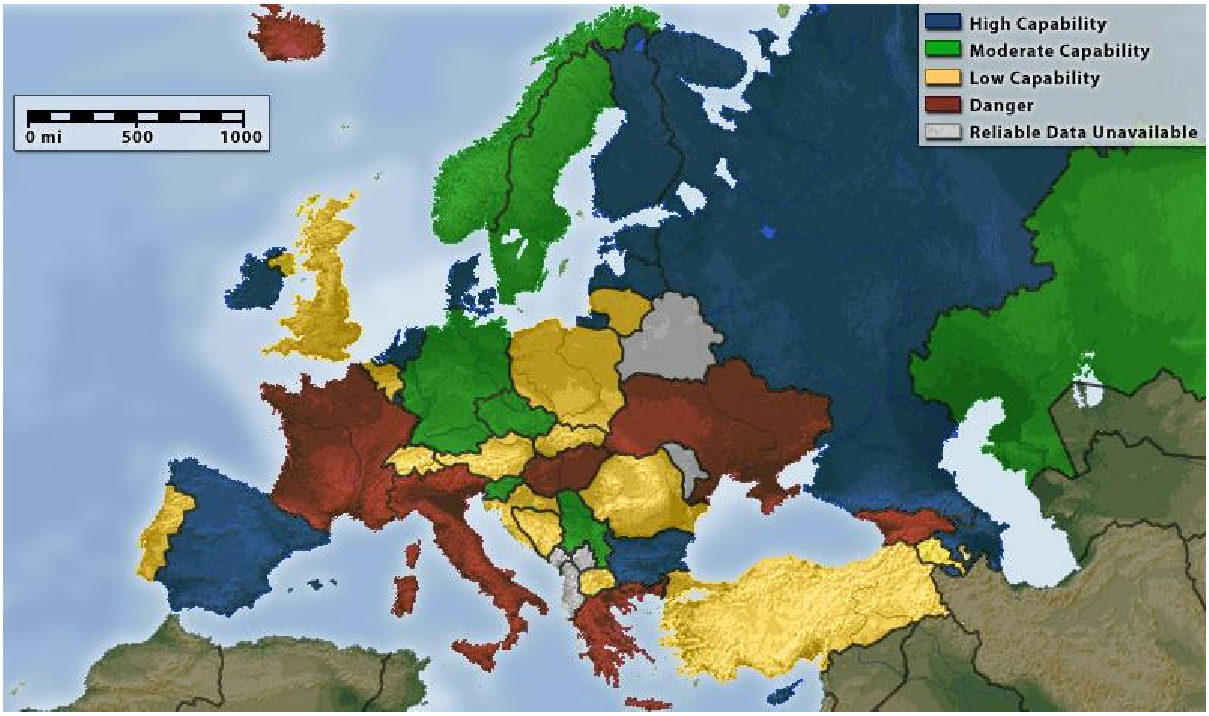
The European Commission published on November 3rd 2009 the first estimations of recession during 2008 and of stagnation during 2009, as well as an increase of unemployment to 2 million people during 2008-2010 [Eurostat, 2009]. In their turn, the German Statistics Department made public on November 5th a plan meant to sustain the economy, and on November 6th the International Monetary Fund (IMF) anticipated that developed countries would enter recession in 2009, the first one after the 2nd World War, and that the rhythm of economic growth would not surpass 2.2%. In the meantime, in the USA unemployment reached 6.5% in November, the maximum level registered in the last 14 years, and Washington declared the abandonment of buying toxic assets from banks, but directly investing in their capital. On November 12th, China also announced a plan for economic growth. Germany, Italy and Hong Kong entered recession, while the Euro zone declared recession for the first time since its establishment, on November 14th. The same announcement came from Japan on November 17th, and two days later a collapsing Iceland obtained financial assistance from the IMF and the Nordic countries. On

November 24th, Great Britain, in recession already, declared a plan for economic growth, and the second day provided more details on plans for sustaining consumption and the real-estate sector. The European Union (EU) finally made their appearance on the stage of state aid at the end of November, when they announced a plan of 200 billion euro for economic revitalization, after seemingly endless divergences between the bigger European economies [Whallen, 2008].

Creating more worries in the international financial environment, USA declared on December 1st 2009 that they had been in recession for a year. Later on, the European Central Bank (ECB) made the widest decision for monetary policy relaxation since its establishment, reducing the interest rate by 0.75 percentage points to 2.5%. Both UK's central bank and the Swedish central bank decreased significantly interest rates, in their turn. A strong relaxation of the monetary policy took place also in the USA, where the US central bank had started the implementation of measures to relax the monetary policy since September 2007, in order to stimulate economic growth. At present, the key interest rate of the Federal Reserve is included in a fluctuation corridor of 0 – 0.25% [World Bank Report, 2009].

In Central and Eastern European countries the situation got worse once the decrease of Western economies started, considering their dependency on those industrial sectors where companies of western origin were predominant. Together with this factor, the crisis was here emphasized by states' incapability – both Western and Central & Eastern states – to cope with possible shocks through adequate economic policies that needed also a certain decision independence given by the economic – financial sector [Isărescu, 2009].

Figure 1. European countries' capability to diminish the effects of the financial-economic crisis in 2008



Source: Stratfor, *The Financial Crisis in Europe*, 2008
http://www.stratfor.com/analysis/20081012_financial_crisis_europe

The map presented above considers three **main indicators**: government's share of the economy, the government budget deficit, and the level of national indebtedness. The study of the administration of the financial crisis with resources, reserves, budget deficit and national indebtedness is only part of the generalized macroeconomic analysis for observing a state's capability to confront the current crisis. The most important element is related to the power with which the state and the national economy are hit. Considering this, a context analysis of the banking markets was needed. The more the banking sector is linked to the international environment, - and especially for the states strongly affected by the current crisis, the more vulnerable it is in times of crisis, having a major impact on the economy and on the macroeconomic situation in the analyzed area [Stratfor, 2008].

The effects of the crisis started to be felt stronger and stronger after the first half of 2008, and in Romania's case even later, starting with the first half of 2009. Sectors that suffered the most were: the car market, metallurgy and air transport, and the unemployment rate significantly increased as more factories started to implement measures to restrain production and other activities [Isărescu, 2009].

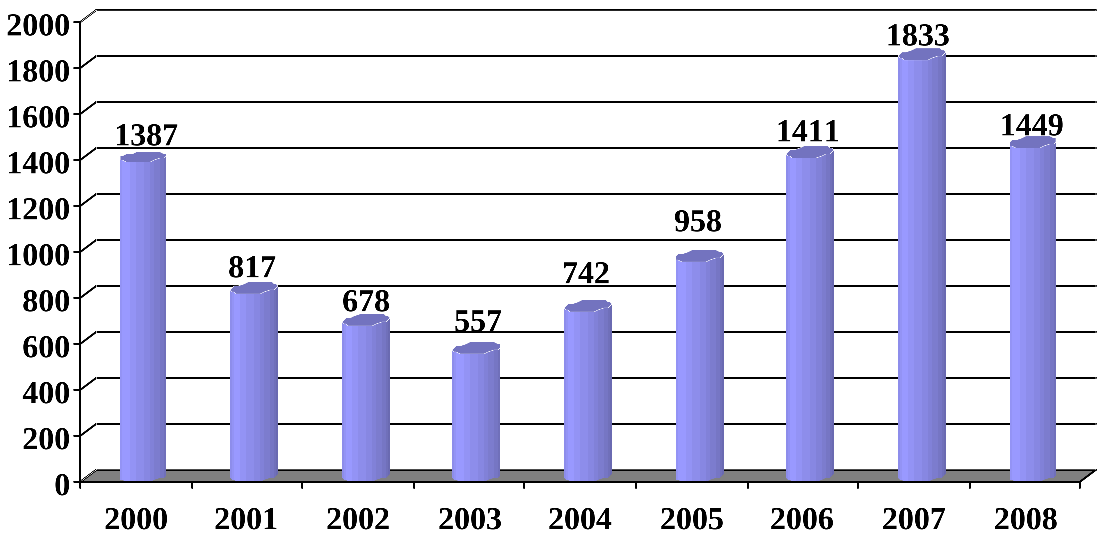
In their forecasting report for 2009, the Organisation for Economic Co-operation and Development (OECD) presented an economic growth rate of 0.3% and a significant increase in unemployment, especially in Europe. As a consequence, the general secretary of OECD estimated for the end of 2009 that between 8 to 10 million jobs would be lost in the organization's area comprised mostly of developed countries, and between 20 and 25 million worldwide, till 2010 [OECD, 2008].

2. The Evolution of Foreign Direct Investments in Romania in the Context of the Economic Crisis

Considering the forecast of the last UNCTAD report (World Investment Report, 2009) in 2008 the global FDI flow decreased by 21%, reaching the value of 1.4 trillion USD. This evolution is due to the beginning of the global economic recession, rough lending terms, decrease of corporate profits, and uncertain perspectives of global economic growth on the short run. The effects of the global crisis vary among regions and countries, fingerprinting thus a different impact on the geographical characteristics of the foreign direct investments flow. Considering that unlike other previous crises the current one originated in developed countries, extending fast to developing countries, the developed countries are those affected most severely. Developing countries register in most cases indirect effects, thus influencing local characteristics of foreign direct investment [BNR, 2009].

In many countries, the flow of incoming foreign direct investments recorded a significant increase of 33% in 2008 as compared to 2007, due to the deepening of the problems financial institutions confront with, and to the liquidity crisis on the monetary and financial market. The decrease of the incomes of transnational corporations in developed countries and the decrease of the credits given by banking unions have considerably limited the financing of investments [World Investment Report, 2009].

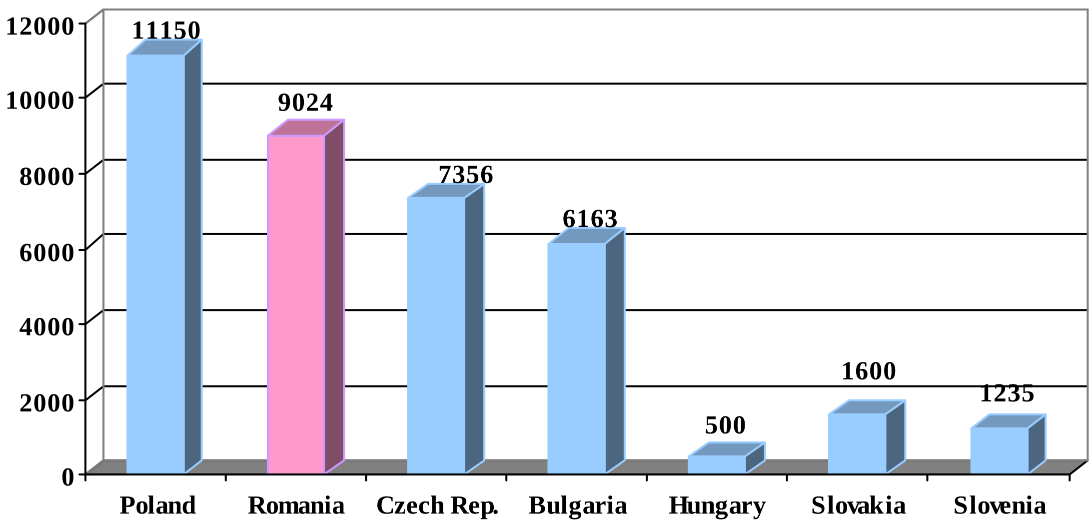
Figure 2. FDI evolution at a global level, 2000-2008



Source: UNCTAD,*World Investment Report 2009*,
http://www.unctad.org/Templates/WebFlyer.asp?intItemID=4629&lang=1

A study published in the summer of 2008 shows that at the level of the whole Europe, Romania ranked fifth in the top of investment destinations, with 10% of the respondent companies stating that they consider Romania for activity expansion. Main competitors of Romania are Poland – chosen by 18% of investors, Germany – 16%, Russia – 12% and France – 11%. "Investment intentions record a slight decline as compared to the previous year, confirming the trend of slowing direct investments at global level", showed the respective study [Ernst&Young, 2009, pp. 290]. As regards the incoming investment projects in 2007 – the year of the subprime crisis burst, Romania ranked first in the top of Central and Eastern Europe countries, and sixth in Europe. In 2008, foreign investors announced a number of 150 projects on the local market, with 7% more than in the previous year, which represents 4% of the total number of investments announced in Europe, 3712 [Ernst&Young, 2009].

Figure 3. Inward FDI in Central & Eastern European countries, 2008 (million EUR)



Source : www.wiiw.ac.at

Most investment projects were conducted in Great Britain – 713, France – 541, Germany – 305, Spain – 256 and Belgium – 175. At the end rank Denmark – 59 projects, Slovakia – 58 and Austria – 45 projects. In 2008, foreign companies' investment projects created around 177 000 new jobs at European level, out of which 7.1% were created in Romania, representing by 12% less than in 2006. Most new jobs were created in Great Britain – 24 186 and in Russia – 14 900, and less in Switzerland – 2200 jobs and Ukraine – 2300 jobs [Ernst&Young, 2009].

Romania's country profile remains industrial considering that 91% of the total number of jobs were created in this sector. Out of these, more than 60% were jobs created in the automotive sector. In the past years, Romania become a real magnet for foreign investors in the automotive sector, winning important projects such as Ford's take-over of Automobile Craiova intending to invest over 675 million USD in the factory, that will create over 3000 new jobs -, and also Renault's investment in Dacia. Furthermore, the automotive sector was the main supplier of new jobs, over 50% of the total number of new jobs being created in this field. The auto sector remains the source of the largest investment projects, the number of new employees hired by companies in this field being 28% higher in 2007 compared to 2006, meaning around 6700 new jobs.

Foreign direct investments in Romania totaled 7.2 billion euro, registering a decrease from 9.1 billion in 2006, amount which includes the privatization of BCR, the largest bank in the system [ARIS, 2009]. At the same time, Romania recorded a sudden increase in the level of foreign direct investments in November 2008, when the capital inflows were almost 40% higher than in the same month of 2007. Foreign investments as capital inflows in Romanian companies was 263 million euro in November, compared to 189 million euro level registered in the same month of the previous year, according to the National Trade Register Office (ONRC) [ARIS, 2009].

Table 1. Top 10 Foreign Investors in Romania in November 2008

Company	**Country of origin**	**Paid-in capital (mn. euro)**
1. Telemobil	The Netherlands	97.1
2. Ruukki Romania	Finland	24.8
3. Provident Financial	UK	17.3
4. Domino Int. Hotels	The Netherlands	16.9
5. Obi România	Germany	14.2
6. Ritzio Bu	Cyprus	13.2
7. ArcelorMittal Galaţi	Switzerland	9.8
8. SW Umwelttechnik	Austria	6.5
9. Project Sierra	The Netherlands	6.4
10. Serafini Mobili	Italy	6.4

Source: ONRC, http://www.onrc.ro/english/statistics.php

In the first 11 months of 2008, the total value of foreign investments was 3.7 billion euro, almost double if compared to the period January – November 2007 value which registered capital increases of 2.07 billion euro. An explanation of this jump of foreign investments could be the fact that foreign investors took into consideration analysts' statements announcing in October the same year that the effects of the international financial crisis would be felt later in Romania.

In 2008, the most favorable months for inward foreign investments were February, with foreign investments as capital increases to the share capital of local companies of 685.7 million euro, July – 462 million euro and January – 443.2 million euro; the most important contribution was brought by E.ON Gaz Romania with a capital increase of over

300 million euro from the main shareholder, the German Group E.ON. This was actually the biggest capital increase performed last year in Romania [ARIS, 2009].

Table 2. Top 10 Investors in Romania, in the first 11 months of 2008

Company	Country of origin	Paid-in capital (mn. euro)
1. E.ON Gaz Romania	Germany	300
2. Telemobil	The Netherlands	228
3. Ion Ţiriac Air	Cyprus	163
4. Credit Europe Bank	The Netherlands	99.8
5. Cosmote	Greece	90
6. Banca Intesa Sanpaolo	Italy	69.2
7. Green Properties	Spain	67.2
8. Egger România	Austria	65.2
9. BelRom	The Netherlands	59
10. BT Asig. Transilvania	France	55.2

Source: ONRC, http://www.onrc.ro/english/statistics.php

In November 2008, the most important investor was Telemobil - the mobile phone operator Zapp, which received from their main shareholder over 97 million euro. In the first half of the last year, Telemobil shareholder decided to increase the share capital with 360 million lei (100 million euro), up to 360.09 million lei, by issuing 144 million shares with a nominal value of 2.5 lei/ share. Till summer, 30% of the issued shares value were paid-in, the difference following to be paid-in by June 2011 [ARIS, 2009].

The second place considering the size of the capital increase is taken by the Finnish Group Ruukki activating on the local market of metallic construction materials with Ruukki Romania, with 24.8 million euro. Third ranks Provident Financial – a consumer credit provider, the local subsidiary of the British Group International Personal Finance -, a company that received in November a capital injection of 17.3 million euro.

The penultimate month of 2008 brought four investments of over 10 million euro; together with Provident, the investors' list comprises also: Domino International Hotels that received from their main shareholder from the Netherlands a capital increase of 16.9 million euro, the German DIY operator OBI owned by the Tengelmann Group with a capital increase of 14.2 million euro, and Ritzio Bu – a subsidiary of Ritzio Entertainment Group from Cyprus that owns Million clubs – with a capital increase of 13.2 million euro. Paid-in capital at companies with foreign shareholders represents a component considered in the measurement of foreign direct investments. According to National Bank of Romania (BNR) data, foreign direct investments cumulated to 8.15 billion euro in the first ten months of 2008, increasing by 37% as compared to the same period of the previous year, when they amounted to 5.958 billion euro [ARIS, 2009].

In the present analysis, the number of new registered companies with foreign capital (12 265 in 2008) represent 77.7% year-on-year. The share capital subscribed for new companies with foreign shareholders represented in 2008 a weight of only 36.3% year-on-year (2007) [ARIS, 2009].

Table 3. Companies with foreign capital established in 2007-2008

	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.	Total
2008	956	1280	1165	1106	1081	1085	1177	825	1047	977	817	748	12264
2007	1111	1282	1555	1199	1454	1413	1368	1272	1205	1411	1357	1155	15782

Source: Trade Register, *Bulletin no. 128*, http://www.onrc.ro/english/statistics.php

In the first month of 2009, the flow of foreign direct investments attracted by Romania was 912 million euro, recording an increase by 51.2% compared to the similar period of 2008 (603 million euro). It can be mentioned that in January 2009 the current account deficit was financed in total by FDI, the biggest share coming from capital subscriptions, respectively 49.6%. As regards the nationality of the investors that publicly announced their future presence in Romania, approximately 65% of them originate from EU Member States, 15% from other European countries, the difference being covered by the USA and Asia [WIR, 2009].

On the short run, it is considered that the negative impact of the global economic and financial crisis on the global flow of foreign direct investments will remain dominant, contributing thus to its continuous decrease in 2009, with the mention that decreases will be recorded at all levels. Still, some factors could contribute to the revitalization of international investments flows. These factors include: investment opportunities given by falling asset prices and industrial restructuring, the existence of financial resources in emergent economies and petrol exporting countries, the rapid expansion of new activities such as unconventional energy resources. In this context, medium term perspectives on the evolution of foreign direct investments' flow at global level are difficult to be assessed. Public policies will play an important role in supplying favorable conditions for re-launching the global FDI flow. The key elements are structural reforms meant to ensure an increased stability of the world financial system, efficient economic incentives given by national governments, renewing the engagement for an open attitude towards FDI, implementation of policies to favor investments and to stimulate innovation especially in the field of environmental protection, renewable energy and small and medium size enterprises [Rato, 2007].

Regarding the horizon 2009-2010, according to UNCTAD experts, the determinants of foreign direct investments will be based on the criteria of the dimension of the home market, resources identification (especially qualified work force, raw materials and financing sources), investment climate stability in the host country and governmental actions' efficiency [WIR, 2009]. From the perspective of corporate functions' internationalization, investment strategies of multinational companies will include not only the production and distribution functions, but also administrative ones – service centers, headquarters and research and development activities. Regarding the distribution among sectors, significant investment projects are expected in the primary and tertiary sectors, especially in utilities and trade. In 2009-2010, the industrial sector is expected to register an advance in environmental protection, renewable energy, information and communication technology, health and biotechnologies.

The strategic competitive advantage held by Romania, even in times of economic crisis, is that of the low workforce cost compared to other Member States of the European Union. Taking this into consideration, the Romanian Agency for Foreign Investments (ARIS) says in the last report that although the evolution of inward investments will be moderate, this will continue even in the years most affected by the economic crisis, following to accentuate the upward trend after the negative effects of the current situation cease [ARIS, 2009].

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