

The Link between Exports and Inward Foreign Direct Investment: The Case of Romania

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Abstract

This paper investigates the economic relationship between a country's exports and foreign direct investment (FDI) carried out by transnational corporations operating within its borders, with a focus on Romania. First, the theoretical background is laid out concerning the circumstances under which transnational corporations shape a country's exports and the extent of their influence. The analysis also concerns the kind of positive stimulus that FDI can trigger for export competitiveness. Then, a short overview is given on the evolution of Romania's foreign trade in the last 10 years, highlighting exports in particular as well as their distribution by sectors. Sectors in which Romania has revealed a comparative advantage over the last years are pointed out. Furthermore, the growth of inward FDI is analyzed, taking into consideration its main destinations within the Romanian economy. The European Union stands out as the main investor in Romania, as well as the main trade partner, but member countries of the EU that top the investor chart do not necessarily top the trade chart as well. The influence of FDI on the competitiveness of Romanian exports is one of the main topics addressed, by investigating if the sectors displaying the largest amounts of FDI have also strengthened Romania's comparative advantage over time. Furthermore, the position of Romania's main exporting companies is contrasted with the largest companies in Romania, ranked by turnover. A special emphasis is put on the nature of proprietorship of these companies: mainly domestic or foreign-owned? Thus, a series of conclusions are drawn on the link between exports and FDI in the case of Romania. Finally, some suggestions concerning the improvement of Romania's export competitiveness are made, by issuing policy recommendations for a strategic approach both for attracting FDI and stimulating exports.

Keywords: exports, foreign direct investment, Romania

JEL classification: F14, F21

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1. Introduction

The share of foreign affiliates of transnational corporations (TNCs) in world exports rose over time, reaching an estimated 33% in 2005 (UNCTAD, 2006). Though, the extent to which foreign affiliates contribute to exports varies greatly from country to country, as UNCTAD statistics demonstrate. The impact of FDI undertaken by TNCs on host-country exports will differ according to its rationale. Resource and efficiency-seekers evidently tend to be more export-oriented than market or strategic asset-seekers. As far as the literature review is concerned, the debate of domestic market vs. export orientation of foreign affiliates generally leads to different conclusions (Smarzynska, 2003, Sgard, 2001). As Meyer (2005) found out for a series of countries, about three quarters of FDI aims at supplying the domestic market in the host country.

Nevertheless, through a variety of spillover effects, inward FDI acts as a competitive spur to domestic firms (UNCTAD, 2006). The role of TNCs in expanding exports of host countries derives from the additional capital, technology and managerial know-how they can bring with them, along with access to global, regional and especially home-country, markets (UNCTAD, 2002). Linkages between foreign affiliates of TNCs and local firms usually trigger the competitiveness of the domestic enterprise sector. Productivity spillovers from FDI through backward linkages (between foreign affiliates and local suppliers) and forward linkages (between foreign affiliates and local customers) can prove very important. As Blomstrom and Kokko (1998) indicate, channels of positive FDI spillovers include: demonstration-imitation effect (knowledge diffusion), competition effect (updating of technology), foreign linkage effect (access to export markets), training effect (movement of staff). Foreign companies induce local suppliers to meet higher quality standards by providing technical assistance and training. Technology transfer translates into higher technological content of exports. This results in increased competitiveness and better export opportunities for the host country.

The beneficial role of FDI for the increasing of competitiveness of Central and Eastern European (CEE) economies is advocated by various researchers (see for example Cantwell

and Piscitello, 1996). In this region, Hungary is the prime exponent for a consistent growth of exports due to foreign investment, as most of the initial FDI took place in manufacturing. As a result, Hungary has rapidly gained market shares internationally (UNCTAD, 2002). In other countries, such as the Czech Republic or Poland, exports increased at a more moderate pace compared to FDI inflows. In Hungary, as well as in other CEE countries, the inclination to export has been higher for foreign affiliates than for domestic firms (Barta, 1997). Nevertheless, Resmini (2000) who based his analysis on data of European firms' FDI in CEE countries suggests that market and strategic issues prevail on export-oriented FDI. However, even if we give credit to the superior export performance in the case of foreign affiliates, it is definitely coupled with a higher import propensity. Thus, FDI has generally tended to expand international trade of the host country, but its outcome on the trade balance is difficult to measure.

2. An Analysis of Romanian Exports

Taking into account the last 10 years we can notice that Romania's foreign trade has risen constantly, but mainly due to the disproportionate growth of imports in the last few years (figure 1). This led to an ever increasing trade deficit (no year with a trade surplus has been recorded in the past decade) amounting to almost \$19 billion in 2006, or 15.4% of GDP.

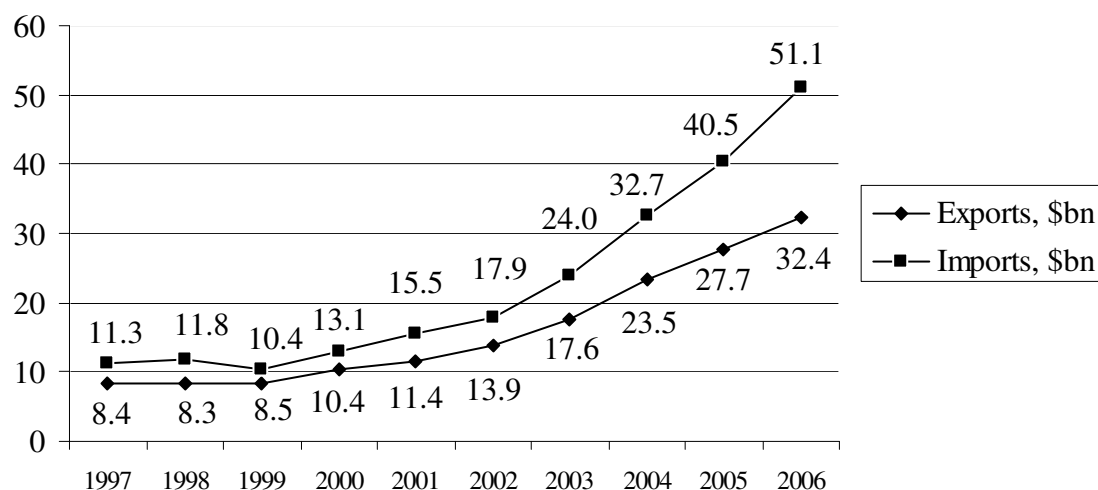


Figure 1. The evolution of Romania's foreign trade

Source: Compiled from National Institute of Statistics (1997-2006)

The composition of Romanian exports has changed in time. Typically, textiles and clothing have represented the major export products (about one-fourth of all exports). Romania became thus the third major exporter of textiles to the EU, behind China and Turkey. Textiles have lost their top spot in Romania's exports in the past two years due to the extraordinary development of machinery, triggered mainly by automotive parts and components (figure 2). Steel and various metals have also been an important product group in Romania's exports throughout the last decade and they kept their important share. With the development of the oil industry, minerals have climbed to the fourth spot in Romanian exports. Another major product group that has developed in the last years for export is that of vehicles, especially after Renault has bought car maker Dacia in 1999.

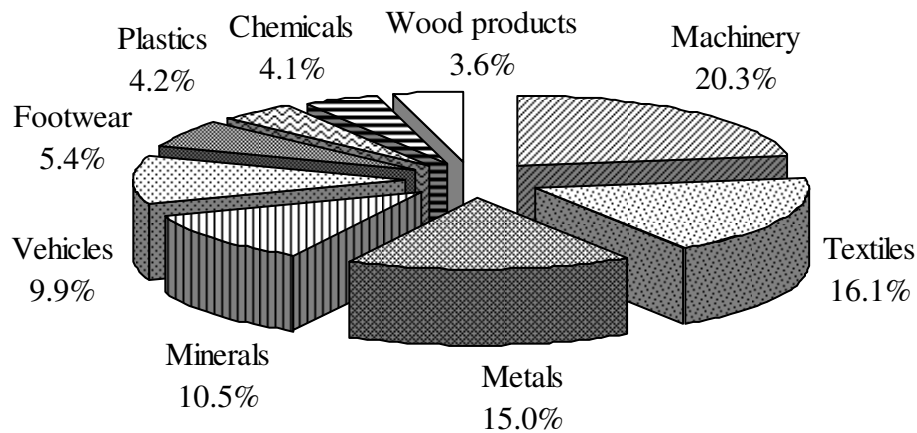


Figure 2. The distribution of Romanian exports on product categories, 2006

Source: Adapted from the Department of Foreign Trade (2006)

The sectors in which Romania has revealed a comparative advantage over the last years are pointed out by calculating the specialization index. The index measures the country's revealed comparative advantage (RCA) in exports according to the Balassa formula (1965):

$$RCA = \frac{\frac{x_j^i}{\sum_{j=1}^n x_j^i}}{\frac{x_j^w}{\sum_{j=1}^n x_j^w}}$$

where: x_j^i = exports of product j of country i, x_j^w = world exports of product j.

The index compares the share of a given sector in national exports with the share of this sector in world exports. Values above 1 indicate that the country is specialized in the sector under review. Data in table 1 suggests that Romania is specialized in furniture, footwear, metals, textiles and clothing.

Table 1. Specialization index of Romania

	2000	2005
Minerals (fuels and mining products)	0.6	0.6
Metals (iron and steel)	7.0	4.8
Chemicals (incl. plastics)	0.8	0.8
Machinery	0.5	0.7
Vehicles (transport equipment)	0.4	0.6
Textiles and clothing	4.2	4.0
Personal + household goods (furniture, footwear, etc.)	7.1	5.9
Other semi-manufactures (leather, wood products, paper etc.)	1.0	0.8

Source: own calculations based on National Institute of Statistics and WTO data

The concentration of Romanian exports on sectors with low productivity and weak technological intensity (textiles and footwear), or high energy consumption (steel) has been a worrying matter throughout the years, but there are signs that the composition of exports is improving with new, higher-technology sectors broadening the portfolio.

Another form of measuring comparative advantage is to calculate the RCA in its “domestic” (internal) meaning. A product is considered to reveal comparative advantage if it is traded more efficiently as compared to the average trade performance of the respective country. RCA of country *i* is derived from the formula:

$$RCA_i = \ln [(x_j / m_j) / (X / M)]$$

where: x_j = exports of product *j*, m_j = imports of product *j*, X = total exports, M = total imports. Positive values indicate areas of comparative advantage, negative values indicate comparative disadvantages. As pointed out by data in table 2, the most pronounced comparative advantage in the case of Romania has been registered in wood products, but it

has decreased, leaving footwear at the top. Other areas of comparative advantage are metals, textiles and furniture, as highlighted by the specialization indexes above. Chemicals and leather products have always been a source of comparative disadvantage, as well as minerals and machinery, but the position of these last two sectors is improving in time.

Table 2. Comparative advantages and disadvantages in Romanian exports

	1997	2001	2006
Minerals (fuels and mining products)	- 1.03	- 0.73	- 0.34
Metals (iron and steel)	1.13	0.59	0.42
Chemicals	- 0.22	- 0.57	- 0.62
Machinery	- 0.96	- 0.43	- 0.17
Vehicles (transport equipment)	0.44	0.02	- 0.15
Textiles and clothing	0.50	0.48	0.69
Furniture	1.21	1.11	0.31
Footwear	1.53	1.66	1.69
Leather products	- 1.14	- 0.95	- 0.74
Wood products	2.14	1.88	1.29

Source: Compiled from Voinea (2002) and own calculations

3. The Evolution of Inward FDI in Romania

Romania performed poorly in attracting FDI compared to other transition countries and to expectations, being the second largest country in Central and Eastern Europe (after Poland). Inward FDI stock reached the \$10 billion benchmark in September 2003, late after Poland, Hungary or the Czech Republic. Despite the steep growth of FDI inflows in the last 3 years (figure 3), FDI stock represented only 32.2% of GDP in 2006 (the highest figure so far)², so its impact on the growth of the economy has to be considered a limited one, especially in the period until 2004.

² Inward FDI stock reached up to only 20.5% of GDP in 2002 (last position among CEE accession countries to the EU) and 24.7% of GDP in 2004.

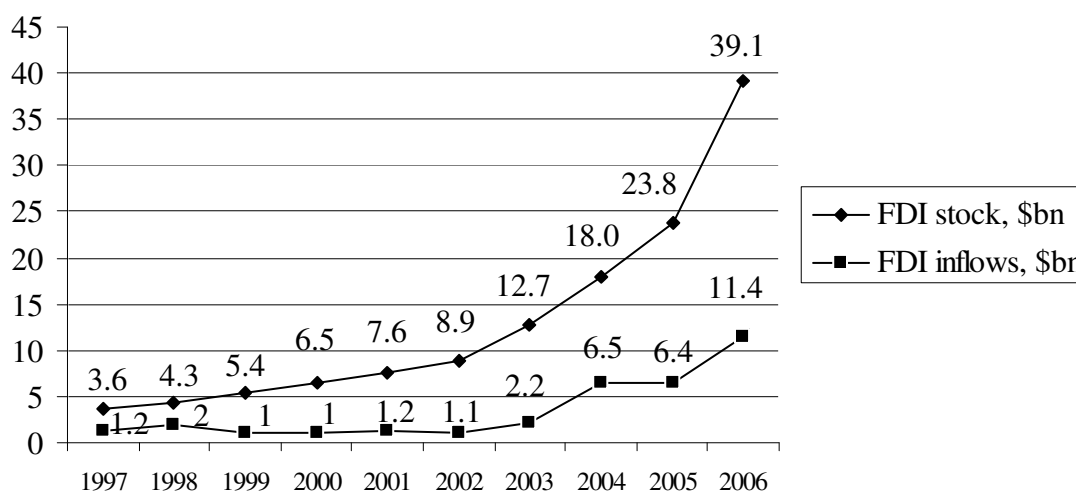


Figure 3. The evolution of FDI in Romania

Source: Compiled from UNCTAD (1997-2005) and the Romanian Agency for Foreign Investment (2006)

The reasons for Romania's poor performance in attracting FDI comprises a long list of factors (see Bonciu, 2001; Marinescu, 2003) but certainly one of the most important has been the delay in reforms and the slow pace of the privatization process. As various studies have shown (Bonciu, 2001; Hunya, 2000), the amount of FDI inflows to CEE countries has been very closely linked to privatization deals. Romania started its "large" privatization scheme in 1997, closing just minor deals until that year. Consequently, FDI flows have been under the \$1 billion mark each year during 1990-1996.

This link between FDI and privatization is also the explanation for the relatively higher amount of FDI in 1998, when a major stake in the Romanian national telephone operator (Romtelecom) has been sold and also for the "record" figures for 2004, 2005 and 2006, when the largest Romanian company – Petrom (the national oil company), and various energy and gas companies have been transferred from the Romanian state to foreign ownership. The outstanding inflows of 2006, the best year for FDI so far, are based on the privatization of the largest Romanian commercial bank (BCR). The control stake was sold for EUR 3.75 billion to Austria's Erste Bank in a deal concluded in December 2005.

In the distribution of FDI by sectors within the Romanian economy, industry still holds the top spot, with 50% of all inward FDI (figure 4). Unlike in other CEE countries, where services are in the lead, in Romania they attracted below 50% of all FDI, despite the large investments in telecommunications, banking and insurance, especially in the last few years. Up to the mid 1990s, trade has been the major destination for FDI. Afterwards industry has started to gain in importance, first the food sector, than the steel industry and automotive industry performing well in attracting FDI.

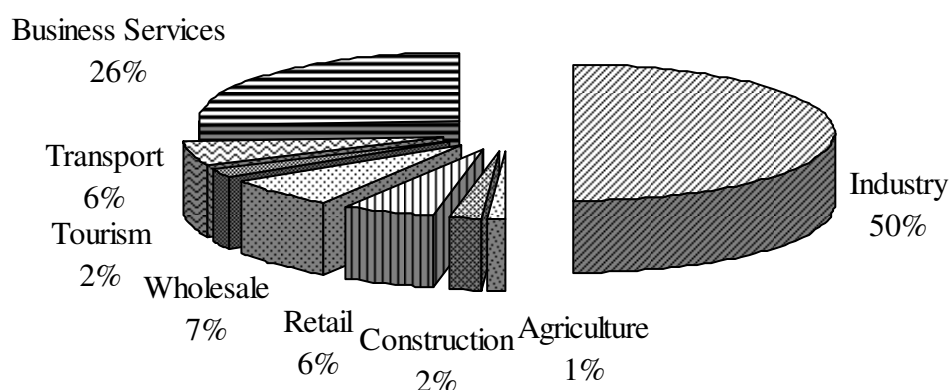


Figure 4. The distribution of FDI in Romania on sectors, 2006

Source: Adapted from the Romanian Agency for Foreign Investment (2006)

4. The Relationship between FDI and Exports

The European Union stands out as the main investor in Romania, with 65% of the FDI stock at the end of 2006, as well as the main trade partner (68% of Romanian exports and 63% of imports)³, but member countries of the EU that top the investor chart do not necessarily top the trade chart as well (table 3). Oddly enough, the number one investing country in Romania from the 1990s onwards has been The Netherlands, and this position is mainly based on greenfield investments. Austria, taking the second spot, has increased its stake in the Romanian economy in an accelerated pace in the last few years by making assiduous acquisitions in the banking and insurance sector. A peculiarity is that the US hold only 2.6% of the FDI stock in Romania and Japan has an insignificant share.

³ According to data from the Romanian Agency for Foreign Investment and the National Institute of Statistics

Table 3. Top 10 export partners and investing countries in Romania (2005)

Rank	Main export partners	Main investing countries
1.	Italy (19.2%)	The Netherlands (19.5%)
2.	Germany (14.0%)	Austria (15.4%)
3.	Turkey (7.9%)	Germany (10.7%)
4.	France (7.4%)	Greece (8.5%)
5.	United Kingdom (5.5%)	France (8.4%)
6.	Hungary (4.2%)	Switzerland (7.1%)
7.	United States of America (4.1%)	Italy (6.9%)
8.	Austria (3.1%)	Cyprus (3.7%)
9.	The Netherlands (2.7%)	United States of America (2.6%)
10.	Bulgaria (2.7%)	Hungary (1.9%)

Source: Compiled from National Institute of Statistics (2005) and the Romanian National Bank (2005)

A slightly different picture emerges when looking at Romania's trade partners. Italy and Germany have traditionally topped this chart, being by far the preferred destinations for Romanian exports. A hint on the relationship between FDI and exports is brought about by the fact that even if these two countries account together for less than 18% of the FDI stock, they have a detached lead compared to other EU members when considering the number of foreign-owned companies in Romania. There are some 21,000 Italian-owned firms and another 14,000 German-owned firms⁴, many of whom are SMEs active in the industrial area and export-oriented.

Analyzing the evolution of FDI inflows in Romania relative to the evolution of exports over the last 10 years, several interesting points emerge. As we can clearly observe, there seems to be no statistical relationship between the two series of data (figure 5). Inward FDI was almost double in size in 1998 compared to the previous year and the following four years, but exports did not follow suit, resting constant and then starting to increase only when the economy has grown significantly, from the year 2000 onwards.

⁴ Based on statistics available from the Romanian Agency for Foreign Investment (2006)

FDI flows tripled in 2004 compared to 2003, but again, exports rose in a less flamboyant manner, just in line with the growth registered in the previous year. The growth rate of exports even decreased in 2006, despite FDI flows registering much higher values in 2004 and 2005 compared to the years before and booming in 2006.

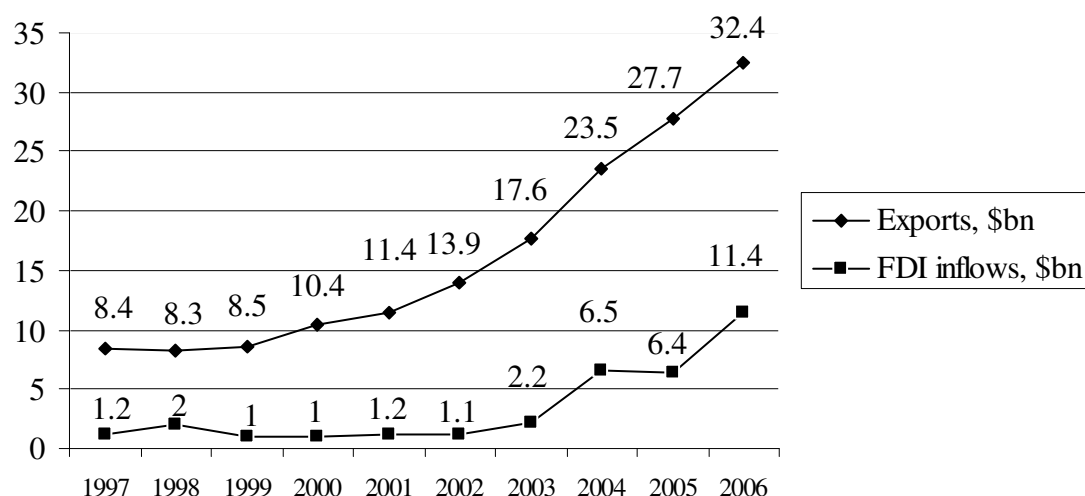


Figure 5. The comparative evolution of FDI inflows and Romanian exports

Source: based on data from the National Institute of Statistics (1997-2006), UNCTAD (1997-2005) and the Romanian Agency for Foreign Investment (2006)

These findings lead us to the conclusion that at least from a statistical point of view, the link between exports and FDI does not seem to manifest itself in the case of Romania. This is also true if we consider that the overall share of foreign affiliates in manufacturing exports has been typically very low (33.4% in 1999, compared to 88.8% in Hungary and 59.8% in Poland)⁵. But the influence of FDI on the competitiveness of Romanian exports can be found from a qualitative point of view. A lot of Romania's industrial sectors were plagued by inefficiency, outdated technology and a bad price / quality ratio for products. Enterprises also lacked international marketing skills. That is why FDI became essential, as it brought much-needed technology, management skills, higher productivity and the ability to access new markets, due to the logistic networks controlled by TNCs. FDI has also helped several enterprises to avoid bankruptcy and to continue exporting.

⁵ See Dumitriu, I., Hunya, G. (2002) for more details.

A question arises if the sectors displaying the largest amounts of FDI have also strengthened Romania's comparative advantage over time. As industry is paramount for export commodities, we look at this category in more detail (table 4).

Table 4. The distribution of FDI stock on selected industries (2005)

Industrial sector	Share in total FDI stock (%)
Metals	8.2
Fuels and mining	7.3
Food and beverages	6.5
Vehicles	5.1
Chemicals	4.1

Source: compiled from the National Bank of Romania (2005)

Of all industries, metallurgy has attracted the highest amount of FDI, one of the areas Romania is mostly specialized in (see table 1), yet comparative advantage is decreasing in this sector (see also table 2). In the fuels and mining industry, the situation has improved over the years. Still it is clearly one of the areas with comparative disadvantage. The food and beverages sector is one mainly domestic market-oriented, with insignificant exports and as well an area of comparative disadvantage. For vehicles and chemicals, not only they are in a position of disadvantage, but the RCA index is declining over time. So evidence shows us that FDI is actually helping out sectors with comparative disadvantage (with the exception of steel) and not strengthening those with comparative advantage. A study by Voinea (2003) confirms that the five sectors receiving most of the FDI inflows are also among those with the highest foreign penetration (share of foreign affiliates in total sales) and explains that the lower presence of FDI in wood products, textiles and footwear (areas of comparative advantage for Romania) is outbalanced by the wide-scale use of subcontracting practices through intermediaries.

Other useful hints on the relationship between exports and FDI are offered by the ranking of Romania's largest companies and its main exporting companies (table 5). In each list, 4 companies out of the first 10 belong to the oil industry, witnessing an important increase in the last years due to the soaring of oil prices. Additional major exporters stem from the

steel industry, automotive industry, electronics and chemical industry. Five of the 10 largest companies can be also found in the ranks of the top 10 exporters.

Table 5. Top 10 exporting companies and largest companies in Romania (2005)

Rank	Main exporting companies	Largest companies, by turnover
1.	Mittal Steel Galati SA	Petrom SA
2.	Petrom SA	Mittal Steel Galati SA
3.	Rompetrol Rafinare SA	Rompetrol Rafinare SA
4.	Petrotel Lukoil SA	Metro Cash&Carry Romania SRL
5.	Alro SA	Automobile Dacia SA
6.	Rafo SA	Petrotel Lukoil SA
7.	Automobile Dacia SA	Romtelecom SA
8.	Solectron Romania SRL	Electrica SA
9.	Oltchim SA	Orange Romania SA
10.	Lisa Draxlmaier Autopart Romania SRL	Lukoil Romania SRL

Source: Compiled from the Department of Foreign Trade (2006) and Finmedia (2006)

When investigating the nature of proprietorship of these companies we notice that 8 of the top 10 exporters and 9 of the 10 largest companies in Romania are foreign-owned. A first glance on this chart could easily lead to the mistaken conclusion that foreign ownership has played an utmost role in boosting exports. But, under closer scrutiny one can observe that at least 4 of the largest companies in Romania are mainly domestic market-oriented and not export-oriented, namely Metro (German cash-and-carry chain), Romtelecom (telephone operator, now under Greek ownership), Electrica SA (energy company, still state-owned) and Orange (mobile phone operator, under French control).

Even the two largest companies in Romania – oil company Petrom (sold in 2004 to Austrian OMV) and steel company Sidex (bought in 2001 by steel giant Ispat, afterwards Mittal Steel) which also lead the exporting chart, have not reached the top spots after they came under foreign ownership. They led the export rankings consistently even before FDI started to gain momentum in Romania. A similar situation can be identified for third-ranked

Rompetrol Rafinare (former Petromidia refinery) and other three companies classified in the top 10 exporters' chart that have been present in this hierarchy throughout the 1990s.

Letting aside Solectron (US company, electronics industry) and Lisa Draexlmaier (German company, automotive industry), both greenfields, cases in which the companies obviously didn't exist before FDI took place, one example of company where FDI has played a chief role for the export-orientation is Automobile Dacia. The national car maker bought 1999 by Renault, exported close to zero in the last years before privatization and since the launch of the Logan model by Renault at the end of 2004, exports have been increasing at a fast pace (from 16,306 exported cars in 2004 to 50,623 in 2005 and 79,438 in 2006)⁶.

5. Concluding Remarks and Policy Recommendations

A series of conclusions can be drawn on the link between inward FDI in Romania and the country's exports. Research has shown that the presence of FDI generally increased the efficiency of the respective sectors: foreign-owned enterprises are characterized by higher productivity, better management and higher propensity to export compared to domestic firms⁷. But, in the case of Romania, no statistical relationship could be found between the evolution of annual FDI inflows and exports. Witness to this is the relatively small foreign penetration rate. With the exception of metallurgy, the largest amounts of FDI were oriented towards sectors with comparative disadvantage and did not develop further the comparative advantage that Romania holds in low value-added sectors. Inward FDI aimed first at resource-based industries then it began to move to more technology-intensive industries, as is the case with the automotive industry.

The largest FDI privatized mainly industrial companies with already above average export propensity or were directed towards various services (telecommunications, banking) and trade, which are typically domestic market-oriented sectors. Thus, in the case of Romania, FDI seems to be rather market-driven than export-driven. This is partly understandable due to the large size of the Romanian market (22 million people) and many underdeveloped

⁶ Dacia – *Press Releases 2006-2007*, www.daciagroup.com

⁷ See also Boşcaiu, V., Mazilu, A. (2001), Hunya (2000), Voinea (2003)

consumer and service sectors. However, the significance of FDI for the increase of exports is not as high as the literature has advocated (Dumitriu and Hunya, 2002, Javorcik et al., 2004). Also, the impact of FDI on the foreign trade balance was not necessarily beneficial. Evidence shows that the increasing export-competitiveness of foreign-owned enterprises came along with increasing import-demand, worsening Romania's trade deficit over time. Nevertheless, the role of FDI should not be underestimated, as its contribution was quite impressive from a qualitative point of view. Positive spillovers to domestic firms include enterprise development and restructuring, enhancing competition on the local market, contribution to international trade integration as well as implementation of a business-oriented culture and modern work mentality.

The improvement of Romania's export competitiveness can be managed with a strategic approach both for attracting FDI and stimulating exports. Legal and macroeconomic stability represent the prerequisites for a better performance in attracting FDI, together with the focus on an improved and investor-friendly business environment, rather than on the use of incentives. This implies identifying and reducing procedural steps, administrative barriers and transaction costs. The adoption of an active promotion policy is needed for attracting FDI as well. The Romanian Agency for Foreign Investment should strive to open foreign offices in key cities of the developed world and to contact major investors, committed to long-run investments, directly at the source. The identification of target countries for outward FDI would be a useful tool, as some of the world's top-investors are underrepresented in Romania. Japan, for instance, accounts for less than 0.5% of the inward FDI stock and the US have a much smaller participation than the CEE average. So as to guide the move of inward FDI towards higher-technology intensive sectors and to increase the domestic value-added content of exports, there is a need for a step-by-step changeover to those dynamic products in world trade for which Romania possesses adequate resources, human capital and specific infrastructure.

The emerging cluster in the automotive industry, featuring car assembly and production of a wide range of components could be boosted further by accelerating the selling of the former Daewoo plant, now Automobile Craiova (back in state ownership) to Ford, which

seems to be one of the most interested contenders. Thus, a second pillar (beside Renault) could emerge and boost the Romanian automotive industry and its exports. Clusters can also be encouraged in selected dynamic areas as IT (with an annual average growth of 21% in the last 5 years in Romania), tourism (with a performance well under its potential) or in sectors for which Romania has a long-lasting export tradition e.g. furniture and wines. Enhancing the export competitiveness of such sectors involves the implementation in each one of them of a well-designed branding and continuous promotional process. This process should be coordinated by regional authorities together with producer and trade associations and chambers of commerce. The targeting of certain potential export-oriented sectors is a necessary task since the National Export Strategy for 2005-2009 sets more than 20 sectors as priorities (!) and the whole document seems rather fuzzy and evasive, comprising more than 180 pages.

As a second step to the activity of targeting, the agencies in charge should eliminate market failures that impede the formation of linkages, encourage domestic sourcing by foreign-owned companies and upgrade existing linkages so as to generate positive spillovers from FDI in the Romanian economy. These bodies can also act as matchmaking agents for domestic firms and foreign investors. Training courses offered to domestic firms, for instance in supply chain management, quality, safety and environmental norms as well as in project management for the absorption of funds from the EU are badly needed to bridge the knowledge gap between foreign affiliates and local firms. Finally, for a more competitive pool of human resources, the educational system has to adapt itself much better to the market needs and strengthen its links to the business environment.

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