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GEOGRAPHICAL DYNAMICS OF FDI IN ROMANIA

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By

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GEOGRAPHICAL DYNAMICS OF FDI IN ROMANIA

A DISSERTATION APPROVED FOR THE
DEPARTMENT OF GEOGRAPHY

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After the change of its political and economic system in 1989, Romania opened its market to foreign investment. However, for most of the 1990s annual foreign direct investment (FDI) flows remained rather modest. They started to increase significantly only after 2003.

This study has several objectives. Firstly, it examines the major characteristics of FDI in Romania (size, mode of entry and industry preference). Secondly, it analyzes the evolution of FDI flows since 1990 in the context of economic and political transition. Thirdly, it analyzes the spatial distribution of FDI within Romania. Fourthly, it examines the geographical origins of foreign investors and the different patterns of investment they generate in Romania. Fifthly, it investigates the main determinants of FDI. And, sixthly, it examines the impact of FDI on the local and national economies.

In order to answer these questions, the study uses a combination of research methods that include archival research, questionnaires and interviews. The study has found that foreign investments in Romania are polarized into very small and large enterprises, a common characteristic for all transition countries. Almost 40 percent of all foreign-owned companies are in the wholesale and retail industries, but investments in the manufacturing sector represent about 50 percent of the FDI stock.

The study also found that FDI is very unevenly distributed within Romania. More than half of all foreign-owned companies and over 50 percent of the FDI stock is concentrated in Bucharest, the capital of Romania. Other regions preferred by foreign investors are the Northwest, the West and the Center while the Southwest and Northeast
have attracted the least foreign investment. Two important conclusions could be derived from these findings. Firstly, physical and cultural distance remain important in influencing the geographical dynamics of FDI. Secondly, those regions that were already more developed have attracted more FDI and/or more foreign investors. This has contributed significantly to the widening development gap between regions.

Characteristics and distribution pattern of FDI are also influenced by the investors’ nationalities, reflecting characteristics from the economic, political, cultural and social environment of their home countries.

In order to understand the main determinants and impact of FDI in Romania, a questionnaire was sent to foreign investors in two industries: the automotive industry and the textile, clothing and footwear (TCF) industry. The questionnaire was followed up by in-depth interviews. The results of this analysis show that, in these two industries, low operating costs and the presence of highly educated and skilled labor are the most important factors in attracting FDI. Proximity to the European Union is also considered important by foreign investors in both industries. On the other hand, the size, strength and potential of the Romanian market shows only limited importance for foreign investors confirming the efficiency-seeking rather than market-seeking character of foreign investments in these two sectors. The impact of foreign automotive and TCF companies on local economies is in general limited to providing employment. These foreign-owned companies have developed limited forward and backward linkages with Romanian companies.

The findings of this research show many similarities to results from other studies in Central and Eastern Europe but also some major differences. The dynamics of FDI in
Romania and other Central and Eastern European countries illustrate the importance of history (path dependence). Characteristics and patterns of FDI in Central and Eastern Europe during the transition years were determined by the different legacies of state socialism together with specific relations between state, economy and society. Another important conclusion of this study is that, in the absence of significant political and economic reforms, FDI is not a solution for jump-starting economic development in a transition country. Rather than foreign investments determining economic transformation, political and economic transformation motivates foreign companies to invest in that country.

In the future, the study would benefit considerably from broadening the scope of the research to include other economic sectors. Also, on January 1, 2007, Romania joined the European Union as its 27th member state. Another study may be necessary in the near future to capture changes in the characteristics and patterns of FDI in Romania following accession to the European Union.
Chapter 1: INTRODUCTION

1.1 Context: FDI and Globalization

The broad context for my research is the globalization of economic activity and the deepening integration of national economies via transnational flows of capital, labor and resources (Dicken 2003; Dicken et al 1997; Giddens 2003; Held et al 1999; Hirst and Thompson 1999). While between 1945 and 1973 growth in international trade was the main factor driving the world economy, after 1980 this role was assumed by the growth in foreign direct investment (Hirst and Thompson 1999: 66). The study of FDI and transnational corporations (TNC) thus provide an excellent vehicle for researching globalization. In Central and Eastern Europe the relevance of FDI in globalization studies is particularly significant given its role in the transition from state socialism to market economy and the integration of the region into the global economy.

FDI is not a new phenomenon. Indeed, Hirst and Thomson (1999) argue that the period prior to World War I (1870-1914) was characterized by significant flows of investments across borders. However, the various enterprises owned by these investors were autonomous from one another rather than integrated through production. Dicken (2003: 10) argues that this “was essentially shallow integration, manifested largely through arm’s length trade in goods and services between independent firms and through international movements of portfolio capital.” On the
other hand, globalization processes that have affected the world economy over the last forty years are associated with a functional integration (representing for Dicken a “deep integration”) of these geographically dispersed activities (ibid).

1.2 FDI and Transition in Central and Eastern Europe

In the case of Central and Eastern Europe, FDI has also played an important role in the economic, political and social transformation of this region, “creating deep systemic changes in the fabric of post-socialist lives and geographies” (Pickles and Smith 2005: 28). As a matter of fact, scholars see internationalization as an important component of economic transition (Bradshaw 2005: 3). The International Monetary Fund (IMF) and the World Bank argued that four actions need to be taken concomitantly in order for the economic transition to be successful: privatization, liberalization, stabilization and internationalization (Stiglitz 2002). Until quite recently a direct correlation could be observed between the geography of FDI in the region and the timing and openness of the privatization process in different countries (Bradshaw 2005).

FDI has also played an important role in the process of economic restructuring in Central and Eastern Europe through the supply of financial capital as well as technology and management know-how (Hunya 2002b). At the same time, it facilitated the integration of Eastern European economies into the global system through inclusion of domestic producers into Western advertising, branding and distribution networks, while Western companies have simultaneously opened retailing outlets in Central and Eastern Europe (Smith 2005; Pavlinek 2005).
1.3 Problem Statement

This research is situated at the confluence of two major areas of inquiry: increasing world economic globalization and economic and political transformation in Eastern Europe. One major goal of this study is to verify the applicability of Western-based FDI theories in the context of transition from state-socialism to market economy in Eastern Europe.

In the orthodox economic literature, FDI is viewed as fundamental to an effective transition to capitalism in the formerly communist economies. Foreign investors are seen to provide not only the capital necessary to restructure the economy but also modern technologies and management practices while opening access to research and development and to global networks of production and trade. Success stories from China and elsewhere have encouraged the belief that FDI is the preferred or even the only solution, to jump-starting a country’s economic development. However this orthodox neo-liberal view ignores the fact that other countries have developed without the participation of significant inflows of FDI, while some that have experienced high levels of inward FDI have failed to see that translated into economic success1 (Pavlinek 1998). It is also quite possible that foreign investment and opening up to global flows may help certain economic sectors while damaging others. Moreover, several scholars have argued that rather than FDI jump-starting economic development, it may well be that economic development and political openness are themselves preconditions to attract FDI (Bandelj 2001).

---

1 For example, Japan managed to achieve rapid economic growth without substantial FDI. On the contrary, maquiladoras in Mexico have attracted high levels of FDI but do not denote economic success in terms of high income for the region or industrial leadership (Pavlinek 1998: 71).
Although considered by many Western-based scholars a prerequisite for a successful transition to a market economy, FDI flows to Romania remained very low during the first six years after the fall of communism. FDI flows then increased to a level between one and two billion dollars per year between 1997 and 2003, which was still much less than the annual FDI flows to Poland, Hungary or the Czech Republic. Significant increase in FDI flows into Romania happened only after 2003. Also the distribution of FDI flows and stock across Romania is very uneven as foreign investors seem to have preferred certain regions while avoiding others. Moreover, there seem to be differences concerning major characteristics and distribution pattern of FDI based on the country of origin. Investments from certain countries are more evenly spread out whereas investments from other countries tend to cluster in certain regions. Also, investors from each country seem to prefer certain modes and types of investment and certain industries. In conclusion, there are important variations in the dynamics and patterns of FDI flows in Romania over time and across space. How can we explain these variations? What are the major factors that determine or influence FDI flows in post-socialist Romania? What are the effects of FDI on the economy?

While similar research has been done in other Central and Eastern European countries, the dynamics and patterns of FDI distribution in Romania have not yet been adequately documented and explained by geographers. This study uses Dunning’s eclectic theory and other Western-based FDI theories to investigate the dynamics of FDI in Romania by examining the principal determinants shaping the geography of FDI and assessing the effects of FDI on national and local economies.
1.4 Research Questions

This study seeks to answer the following research questions:

I. **What are the dynamics and major characteristics of FDI in Romania?** The study examines the evolution of FDI flows in post-1990 Romania seeking to explain the changes that have occurred over time in the FDI flow. To do so, I discuss the political and economic history of pre-1990 Romania as well as the changes that have occurred during the transition period. This research also analyzes the main characteristics of FDI in Romania in terms of size, mode of entry and sectoral distribution. Another question this study attempts to answer is how do FDI characteristics (such as size, mode of entry, economic sector and structure of ownership) and geographical distribution differ based on the country of origin.

II. **How is FDI distributed geographically in Romania?** Here I will examine the distribution of both, foreign capital invested and foreign-owned companies across Romania.

III. **What are the most important factors that determine FDI flows to Romania?** Why do foreign investors prefer Romania over other countries in the region? Also, what are the most important determinants for site selection?

IV. **What is the impact of FDI on local and national economies?** The study will examine the embeddness of foreign-owned companies into the local and national networks of suppliers and customers.
In addition, this study aims to contribute to the theory of FDI in transition countries and is expected to have policy implications.

1.5 Limitations of the Study

This study, while covering a lot of ground, is by no means exhaustive. Firstly, the study examines in detail only two manufacturing sectors. Therefore, all results pertaining to the determinants and effects of FDI are specific to these two sectors. Further studies to include other economic sectors are needed and expected in the near future in order to have a more complete image of FDI dynamics in Romania.

Secondly, although I use the term “geographical” in the title of this study, I did not intend to cover the entire spectrum of definitions for geography and all five themes. For example, the relationship between FDI and environment is not discussed in this study. This relationship is very complex and deserves a separate study. Rather, the use of the term “geographical” shows that the study focuses on the geographical aspects of FDI (location, place, region, and direction of movement) and not economic or sociological aspects.

Thirdly, while I tried to do my best to show the influence of politics and regulation on FDI decision, I realize that I barely scratched the surface and more studies would be necessary to unearth this intricate relationship. Some indicators are also very difficult to measure. For example, everybody agrees that corruption has a negative impact on FDI but the exact impact of corruption on FDI flows is difficult to assess. My survey and the following interviews did not identify corruption as a
significant hindrance for foreign investments. The respondents rather complained about the frequently changing legislation. They viewed corruption more as a nuisance and it did not deter them from investing in Romania. However, it could be argued that my survey may not have reached those foreign investors who had bad experience with corruption in Romania as these may have decided not to invest or to withdraw their investment.

Fourthly, the impact of NATO and EU membership on FDI flows is also difficult to assess and deserves a study on its own. Anyone examining the evolution of FDI flows in Romania could see that the most significant increase in FDI happened after 2003, the year when Romania was admitted in NATO and a decision was made to consider Romania for a 2007 accession in the EU. However, it would be very difficult to argue that the significant surge in FDI flows after 2003 could be entirely explained by the prospect of joining the Euro-Atlantic organizations. It is true that this was an incentive for the Romanian government to speed-up reforms in order to comply with the EU legislation. This, in turn made the country more attractive to foreign investors. However, the bulk of the FDI resulted from the large privatization deals and not from greenfield investments. This raises the question whether the current high level of FDI could be sustained after all privatizations are completed.

Fifthly, my discussion of local impacts is also limited to the effects on backward and forward linkages. As mentioned in the literature review chapter, the impact of FDI on host economies can be broken down into direct effects, indirect
effects and wider effects. This study focuses only on indirect effects and even those only narrowly.

1.6 Organization of Dissertation

The study is organized into nine chapters. The first chapter introduces the research context, the problem statement and the research questions. Chapter Two reviews existing theoretical and empirical works on the determinants and impact of FDI. Chapter Three provides an overview of Romania’s economic history while Chapter Four presents the research design and methodology. Chapter Five analyzes the geographical dynamics of FDI in Romania focusing on the origins of FDI and the distribution of FDI within Romania. Chapter Six analyzes the different patterns of investment based on investors’ country of origin. Chapters Seven and Eight investigate the main determinants of foreign direct investment and their impact on local and national economies. The empirical material focuses on two manufacturing sectors: the automotive industry (Chapter Seven) and the textile, clothing and footwear industry (Chapter Eight). Finally, Chapter Nine summarizes the findings and establishes an agenda for further research.

1.7 Terms and Concepts

The International Monetary Fund (IMF) defines foreign direct investment (FDI) as the acquisition of at least 10 percent of the ordinary shares or voting powers of an enterprise by a direct investor residing in another country (IMF 2003). This is to distinguish FDI from portfolio investment (FPI), which is the passive holding of
financial assets in a foreign company and which does not entail active management or control of these assets. In the case of FDI, investors have total control of the acquired securities and financial assets even if they lack control of the company as a whole (Gaile and Hannink 1984; Graham and Krugman 1993; Jermakowicz 1995).

There are two major forms of FDI: greenfield investment and investment through mergers and acquisitions (M&A). Greenfield investments refer to those situations in which a new business is built de novo using foreign capital. When the investment is in manufacturing it entails the construction of a new physical plant. A company can also enter a foreign market through merger with or acquisition of an existing firm. One form of M&A that is particularly important in Eastern Europe involves the privatization of state-owned enterprises. In many cases, greenfield investments are preferred by host countries because this mode of investment is more clearly associated with the creation of new employment, with technology transfer and because competition is stimulated by adding new entrants to the market (McCullough 1993; Pigozzi and Bagchi-Sen 1995; Antaloczi and Sass 2001; Wes and Lankes 2001). On the other hand, some studies have shown that companies acquired through the privatization process tend to be more embedded in host local economies than greenfield investments (Antaloczy and Sass 2001; Wes and Lankes 2001).

In terms of flow direction, there are also two types of FDI. Inward FDI refers to the FDI that is entering the country; while outward FDI refers to the investment leaving the country.
1.8 Global FDI Flows

The deepening of global economic integration is clearly illustrated by increased flows of foreign direct investment. Global annual FDI inflows increased from an annual average of less than $50 billion between 1980 and 1984 to more than $1.4 trillion in 2000 before dropping to $560 billion in 2003 (UNCTAD 2004; figure 1.1). The drop in FDI flows is likely a consequence of “the worldwide deceleration in growth” (Mody 2004: 1200). In addition, vast privatization and deregulation programs initiated in both developed and developing countries in the 1990s had reached an end by the beginning of the 2000s (Hirst and Thompson 1999; Miyake and Sass 2000). In 2005 global FDI inflows increased slightly to $916 billion on account of a new wave of cross-border mergers and acquisitions (M & A) to developing countries (UNCTAD 2006).
1.9 FDI in Central and Eastern Europe

FDI inflows in Eastern and Central Europe followed the same pattern (Figures 1.2 and 1.3) with Romania exhibiting the most significant change in FDI from around $1 billion annually between 1997 and 2003 to over $11.4 billion in 2006 (Figures 1.2, 1.3 and 1.4).
Figure 1.2: Annual Inward FDI Flows - Central Europe.
Source: UNCTAD (2007)
Annual FDI inflows in Central and Eastern Europe declined sharply from a high of US$31 billion in 2002 to US$21 billion in 2003 and then increased again to over US$50 billion in 2005 (UNCTAD 2004; 2006). The significant drop in inward FDI between 2002 and 2003 was mostly due to the end of privatization program in the most advanced countries in the region while greenfield investments were slow to arrive (Hunya and Stankovsky 2004). Moreover, greenfield projects are usually smaller in size and extend over a longer period of time, which makes them less likely to compensate over the short-term for the fall in privatization-related FDI (UNCTAD 2004). In 2004, however, eight Central European countries joined the European Union and this attracted a number of significant greenfield investments.
Moreover, less advanced countries like Romania, Bulgaria, Croatia and Serbia started to privatize their strategic assets such as banks and utility companies only after 2003. These countries did not follow the same pattern of FDI development but instead witnessed a sustained growth in inward FDI throughout the 2000s. Three countries from this region were included among the global top ten emerging market destinations for FDI in 2006: Russia (3rd), Poland (8th) and Romania (10th) (The Economist Intelligence Unit 2007c). However, although inward FDI in CEE has increased considerably since the 1990s, the amount of foreign capital invested directly in this region represents only 5.5 percent of global FDI flows (UNCTAD 2006).

![Annual FDI flows](image)

Figure 1.4: FDI Flows to Romania.
Some experts argue that FDI flows in the region may have peaked in 2006 and are likely to decline slowly from that point (The Economist Intelligence Unit 2007c). Other scholars had earlier predicted that FDI would increase dramatically following entry of several countries from Central and Eastern Europe into the European Union (EU), as more Western European companies sought to invest in the region in order to expand their markets and take advantage of cheaper operating costs. So far this increase has not yet materialized. While there has been an increase in FDI inflows in most economies in the area, this increase occurred largely because of significant privatization deals, growth in reinvested profits and a real-estate boom rather than as a consequence of Western companies moving into the region (The Economist Intelligence Unit 2007c). This is not to say that EU membership has failed to influence FDI flows into the region. Membership and the prospect of membership have pressured governments in the region to speed up political and economic reforms, making these countries more attractive to foreign investors. However, membership in the EU has also removed some of the characteristics that had previously made these economies attractive to FDI. Stronger currencies and increasing labor costs in the region have made operating in these markets more difficult, especially for resource-driven foreign investors. Adherence to EU regulations has also reduced flexibility and imposed additional costs while elimination of special FDI incentives, following EU directives, has reduced the attractiveness of the region in the eyes of many foreign investors. Given this ambivalence to EU membership as a factor for attracting FDI and the near-exhaustion of major privatization opportunities in the region, many experts predict a

1.10 Romania: The Spatial Context

Romania, the newest addition (since January 1st 2007) to the European Union (along with Bulgaria) is a mid-sized country situated in Southeastern Europe with an area of 93,043 square miles (238,392 square kilometers) and a population of 21,623,849 inhabitants (est. July 1st, 20052) making it the ninth largest country in the European Union and seventh largest by population.

1.10.1 History

Romania is a relatively young country. It was established in 1859 when two Romanian-speaking principalities, Moldavia and Wallachia decided to unite under the name “United Principalities.” The new state remained under Ottoman suzerainty until 1878 when it gained independence. Three years later it became a kingdom. After World War I, Romania acquired Transylvania, Banat and Bukovina from a collapsing Austria-Hungary Empire and Bessarabia (approximately today’s Republic of Moldova) from a Russian Empire troubled by the Bolshevik Revolution. Territories were subsequently lost and gained and its current borders were established after World War II, when Bessarabia and the northern half of

Bukovina were ceded to the Soviet Union. These frequent border changes provide a partial explanation for the existence of numerous ethnic minorities in Romania.

1.10.2 Physical Setting

Topography is varied, with mountains, intermediary landforms (hills and plateaus) and lowland representing each approximately one-third of Romania’s territory. The Carpathian Mountains represent the backbone of the Romanian topography extending for over 1000 kilometers to form an arc around the Transylvanian Plateau. Compared to the Alps, the Carpathians are less massive and are characterized by low and medium altitudes. The Carpathian Mountains are then surrounded by plateaus and hills which toward east, south and west transition to lowland areas in an amphitheater-like disposition. The location of Carpathian Mountains in central Romania is obstructing circulation between Western Romania and the rest of the country.

Natural resources are varied but not abundant. Gold and silver have been known and mined for more than 2000 years as were other non-ferrous metals, iron ore and salt. Romania is also one of the first countries in the world to industrially extract and refine oil. Romania has also been mining coal; however coal reserves are much smaller and of lower quality than in other European countries. Therefore, although Romania has a variety of natural resources they are generally of lower quality and less abundant due partly to centuries of mining.
1.10.3 Administrative Division

Romania is divided into 42 administrative counties (including the urban county of Bucharest) and eight development regions that presently have no administrative functions and are designed only to provide a vehicle for managing and disbursing various EU accession funds (figure 1.5). Each of these regions (Northwest, West, Southwest, South, Southeast, Northeast, Central and Bucharest) comprises an average of five counties. Several historical regions are also mentioned throughout this study and these are shown in figure 1.6.

Figure 1.5: Counties and development regions in Romania
1.10.4 Population

The total population of Romania has been decreasing steadily since 1990. Between 1990 and 2005 Romania’s population fell by 1,582,871 people representing 6.8 percent of its 1990 population. This is mainly the result of a combination of very low birth rates and increasing death rates. Birth rates dropped from 13.6 per thousand in 1990 to 10.2 per thousand in 2005 while death rates have increased in the same period from 10.6 per thousand to 12.2 per thousand. These changes resulted in a negative natural growth of population in 2005 of 0.2 per cent. An aging population is expected to only exacerbate the situation in the future. Table 1.1 shows how the population in the 0-14 year cohort has decreased from 23.6 percent
in 1990 to only 15.6 percent in 2005 while the percentage of population 60 and older has increased from 15.6 percent to 19.3 percent during the same time period.

<table>
<thead>
<tr>
<th>Population Cohort</th>
<th>1990</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>0-14</td>
<td>23.6</td>
<td>15.6</td>
</tr>
<tr>
<td>15-59</td>
<td>60.8</td>
<td>65.1</td>
</tr>
<tr>
<td>60+</td>
<td>15.6</td>
<td>19.3</td>
</tr>
</tbody>
</table>

Table 1.1: Demographic characteristics - Romania.

In-migration is minimal whereas out-migration has picked up, especially after 2004 when visas were eliminated for Romanian citizens allowing them to travel freely and find jobs in many European Union countries. Net migration is therefore chronically negative. Exactly how many Romanians live and work abroad is unknown (Bobocea 2005). The Ministry of Foreign Affairs has estimated the number of Romanians working abroad legally (mostly in the EU countries) at 1.2 million, while the Ministry of Labor puts the figure at two million including those who work illegally. One of the country’s largest labor union blocs estimates the number at no less than 3.4 million, including those who have temporary jobs (Serbanescu 2007).

Since most of these emigrants are young (in the 15-59 age cohort) the demographic catastrophe facing Romania is serious. Romania has an unemployment rate significantly lower than other European countries. According to European Union’s Central Statistics Bureau (Eurostat 2007), in 2006 the unemployment rate
in Romania was 7.3 percent while the EU-27 average was 8.1 percent. However, in Bucharest and most of western Romania unemployment rate is around two percent (BBC News 2006) While millions of Romanians have found jobs abroad, Romania has a labor deficit of half a million people, according to the Romanian Finance Minister, Varujan Vosganian (BBC 2007). The most affected sectors are construction, hospitality (hotels, restaurants and catering) and the textile and clothing industry (Pahoncia 2007). If the situation does not improve in the near future (and the only way this may happen is if Romanians working abroad decide to return), it is very likely that employers will soon resort to importing labor from other countries (Ziarul Financiar 2007a).

Almost 55 percent of the total population lives in urban settlements. This has changed little since 1990 (when the percentage was 54.3 percent) and is one of the lowest in Europe. In the European Union only Slovenia has a lower urbanization rate (51 percent) and in Europe there are only four other less urbanized countries: Albania (45.4 percent), Bosnia and Herzegovina (45.7 percent), Republic of Moldova (46.7 percent) and Serbia and Montenegro (46.7 percent) (United Nations 2005).

Population is unevenly distributed across the country, but the differences in population density among counties are not extreme. The lowest densities are in the mountainous counties and the Danube Delta (Caras-Severin, Harghita and Tulcea counties with 30-50 inhabitants per square kilometer) and the highest densities are in counties around Bucharest (Ilfov, Prahova and Dambovita with densities

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3 In March 2007 unemployment rate in Romania decreased to 5.2 percent (Smart Financial 2007).
4 The Labor Minister, Paul Pacuraru has mentioned a deficit of no less than 1.5 million workers (Euractiv 2007).
between 130 and 190 inhabitants per square kilometer) and in Eastern Romania (Iasi and Galati counties with 135-150 inhabitants per square kilometer).

There are 18 recognized minorities in Romania. Hungarians, the largest minority, represent 6.6 percent of the population (according to the 2002 census). However, Hungarians represent the majority of the population in the counties of Harghita and Covasna and a sizeable minority throughout Transylvania and Banat (figure 1.7). Romas or Gypsies represent another two percent of the total population and are fairly evenly distributed across the country. The other recognized minorities (Ukrainians, Germans, Lipovans, Turks, Tatars, Serbs, Slovaks, Bulgarians, Croats, Greeks, Russians, Jews, Czechs, Poles, Italians and Armenians) together make up 1.4 percent of the population. Most of these minorities are found in Transylvania, Banat and Southern Bukovina except for Greeks, Turks and Lipovans who live mostly in the Old Kingdom (Moldova and Wallachia).
With the notable exception of Romas, the proportion of most other minorities in the total population has been diminishing (table 1.2). Two minorities which have seen massive reduction in their number after World War II are Germans and Jews, who migrated in large numbers to Germany and Israel respectively. There were over 745,000 Germans counted in Romania by the 1930 Census, representing 4.1 percent of the total population. Not considering Bessarabia and Northern Bukovina, which are no longer part of Romania, their number was 588,000 with most of the Germans concentrated in Transylvania (253,426 or 7.9 percent of the population), Banat (223,167 or 23.7 percent of the population) and Crisana-Maramures (67,259 or 4.8 percent of total population). However, several thousand
German families were deported after the war after having been accused of collaboration with the Nazis. The mass migration started in the 1970s following an accord between Romania and West Germany. By 1977 the German population was reduced to almost half its 1930 number (332,205) and by 2002 there were less than 60,000 Germans left in Romania representing only 0.27 percent of total population. However, the regions and counties with the highest percentages of German population remained approximately the same as in 1930 (figure 1.8).
<table>
<thead>
<tr>
<th></th>
<th>1930</th>
<th>1977</th>
<th>2002</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Population</td>
<td>18,057,028(^5)</td>
<td>21,559,910</td>
<td>21,680,974</td>
</tr>
<tr>
<td>Romanians</td>
<td>12,981,324</td>
<td>19,207,491</td>
<td>19,399,597</td>
</tr>
<tr>
<td>Hungarians</td>
<td>1,425,507</td>
<td>1,670,568</td>
<td>1,431,807</td>
</tr>
<tr>
<td>Romas (Gypsies)</td>
<td>262,501</td>
<td>75,696</td>
<td>535,140</td>
</tr>
<tr>
<td>Ukrainians</td>
<td>582,115(^6)</td>
<td>51,503</td>
<td>61,098</td>
</tr>
<tr>
<td>Germans</td>
<td>745,421(^7)</td>
<td>332,205</td>
<td>59,764</td>
</tr>
<tr>
<td>Russians + Lipovans</td>
<td>409,150(^8)</td>
<td>17,480(^9)</td>
<td>35,791</td>
</tr>
<tr>
<td>Turks</td>
<td>154,772(^10)</td>
<td>20,750</td>
<td>32,098</td>
</tr>
<tr>
<td>Tatars</td>
<td>22,141</td>
<td>20,508</td>
<td>23,935</td>
</tr>
<tr>
<td>Serbians + Croatians</td>
<td>51,062</td>
<td>38,252</td>
<td>29,368</td>
</tr>
<tr>
<td>Slovaks + Czechs</td>
<td>51,842</td>
<td>25,020</td>
<td>21,167</td>
</tr>
<tr>
<td>Bulgarians</td>
<td>366,384(^11)</td>
<td>9,267</td>
<td>8,025</td>
</tr>
<tr>
<td>Greeks</td>
<td>26,495</td>
<td>5,092</td>
<td>6,472</td>
</tr>
<tr>
<td>Jews</td>
<td>728,115(^12)</td>
<td>24,667</td>
<td>5,785</td>
</tr>
<tr>
<td>Poles</td>
<td>48,310(^13)</td>
<td>3,481</td>
<td>3,559</td>
</tr>
<tr>
<td>Armenians</td>
<td>15,544</td>
<td>1,410</td>
<td>1,780</td>
</tr>
<tr>
<td>Other</td>
<td>179,225</td>
<td>56,520</td>
<td>23,647</td>
</tr>
<tr>
<td>Percentage Minority</td>
<td>28.1</td>
<td>10.91</td>
<td>10.52</td>
</tr>
</tbody>
</table>

Table 1.2: Minority population in Romania, 1930-2002

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5 It includes Bessarabia, Northern Bukovina and Southern Dobrudja which are no longer part of Romania.
6 Including those living in Bessarabia and Northern Bukovina.
7 Including Bessarabia and Northern Bukovina.
8 Including Bessarabia and Bukovina.
9 Not including Lipovans.
10 Including Turks living in Southern Dobrudja.
11 Including Bulgarians from Bessarabia and Southern Dobrudja.
12 Including Jews in the territories that were lost by Romania after WWII.
13 Including Northern Bukovina.
Figure 1.8: Distribution of German population in Romania in 2002 (in percentage, out of total German population).

Even though there are very few Germans left in Romania they are still influential in the regions where they once made up the majority of the population. Germans originally from Romania visit their Romanian relatives and their native towns regularly, often getting involved in the local communities. Although it represents a relatively small population, the Democratic Forum of Germans in Romania has won elections in several localities in the Sibiu and Satu Mare counties including the cities of Sibiu (154,000 inhabitants) and Medias (54,000 inhabitants). In the city of Sibiu the German political party has won the office of the mayor (Klaus Johannis) and 16 of the 23 seats in the Municipal Council. At the county level, the Democratic Forum of Germans in Romania has won eleven of the 33 council seats.
The Jewish population was also sizeable prior to 1940. According to the 1930 Census there were 728,115 Jews representing 4 percent of the total population. During the war, Romania’s Jewish population was subject to pogroms and deportations to Nazi concentration camps. After 1945 most of the Jews who survived the genocide decided to emigrate to Israel. By 1977 their number had dropped to less than 25,000 and at the 2002 Census only 5785 Jews were counted in Romania. Jewish émigrés have been less influential in the Romanian economy, although many have returned to invest in Romania (Bran 2007).

1.10.5 Economy

Romania is one of the fastest growing economies in Europe. Indeed, the rate of economic growth was one of the highest in the world at 7.7 percent in 2006. It slowed slightly in 2007, although it was still estimated at around 6.5 percent (The Economist Intelligence Unit 2007b). However this growth is powered by rampant private consumption rather than production and exports (ibid). The current account deficit represented 11.6 percent of GDP in the first quarter of 2007. Foreign direct investment covered 36 percent of the current-account deficit, much less than in previous years (The Economist Intelligence Unit 2007b). Romania also ran a fiscal deficit of 1.6 percent of GDP in 2006 but this has increased considerably in 2007 running close to the EU-mandated three percent of GDP limit (The Economist Intelligence Unit 2007b). Many experts worry about the economy becoming overheated with the resurgence of inflation being a possible outcome (The Economist Intelligence Unit 2007b). Substantially contributing to inflationary
pressure are recent government decisions to raise pensions and wages in the public sector which will likely spill over to the private sector (ibid). As the macroeconomic imbalance is worsening Romania is moving away from meeting the Maastricht criteria\textsuperscript{14} required to adopt the common European currency (ibid.).

Industry, which in the past was the strongest economic sector, is losing importance relative to other sectors. Its share of GDP has dropped from 46.2 percent in 1989 to 34.9 percent in 2006 (Maniu 2006; The Economist Intelligence Unit 2007a). Many manufacturing sectors are in serious decline (Wall Street 2006), and Romania’s accession to the EU may reinforce this downward spiraling as Romanian industries may be unprepared to compete directly with EU companies. Labor productivity is very low compared to the EU. For instance in the wood processing industry labor productivity is only 11,000 euros per employee compared to 97,000 euros per employee in the EU; in the automotive industry productivity is one-sixth that in the EU (Wall-Street 2006). Among the worst-performing industries is the textile, garments and footwear industry, long considered one of the engines of economic development given its role in accounting for a significant percentage of total Romanian exports. Exports of textile and clothing to the EU represented 36.4 percent of total Romanian exports to the EU in 2002 but by 2006 it represented only

\textsuperscript{14} The Maastricht (or convergence) criteria for the adoption of euro are:

1) inflation rate no more than 1.5 percentage points higher than the three lowest inflation member states of the EU;
2) at the end of the previous fiscal year, the ratio of annual government deficit to GDP (gross domestic product) must not exceed three percent;
3) at the end of the previous fiscal year, the ratio of gross government debt to GDP must not exceed 60 percent;
4) applicant countries must join the exchange rate mechanism under the European Monetary System two years before adopting the euro and should not devalue their currency during this period;
5) the nominal long-term interest rate must not be more than two percentage points higher than in the three member states with the lowest inflation rates.
23.0 percent (Eurostat 2007). The textile, clothing and footwear industry has declined by an average of 3 percent annually between 1999 and 2004 (Wall-Street 2006). Another poor performer is the food processing sector which is considered one of the strategic industries after accession (ibid).

A few industries exhibit growth. Among these, the wood processing and furniture sector has grown 16 percent between 1999 and 2004 (Wall-Street 2006). Another is the automotive sector. Its contribution to Romania’s total exports to the EU increased from 2.1 percent in 2002 to 5.9 percent in 2006 (Eurostat 2007). Industry experts believe that the automotive industry will add 12,000 new jobs in 2008 (Serban 2007). Many of these new jobs will be provided by foreign companies. Multinational corporations are represented among the top ten companies in each manufacturing sector and in 17 of the 23 a multinational is the largest firm in the sector (Wall-Street 2006).

Romania has 4.5 million farms representing almost a third of all farms in the European Union (The Economist 2007). Most of these landholdings are very small, the average being less than three hectares\(^\text{15}\) (Adevarul 2006). Over 60 percent of Romania’s agriculture is subsistence agriculture (Curierul National 2006). The share of agriculture in GDP represented around 11 percent of GDP\(^\text{16}\), still very high compared to other countries in the EU\(^\text{17}\). Moreover it concentrates 30 percent of the

\(^{15}\) In the south the average farm has less than 1.5 hectares of land. About 94 percent of all farms have under five hectares (Adevarul 2006).

\(^{16}\) According to the Economist Intelligence Unit (2007a) agriculture’s share in GDP was 9.1 percent.

\(^{17}\) For example in Germany, the share of agriculture represents only one percent of the GDP, in Sweden, Austria and UK two percent and in France and Italy three percent (Cole and Cole 1997).
labor force\textsuperscript{18} in Romania\textsuperscript{19}. However most of the farmers are old; 40 percent of all farmers are over 65 and only nine percent are under 35 years (Adevarul 2006).

The effects of EU accession on Romanian agriculture are mixed. On the one hand Romania is positioned to receive substantial EU subsidies in accordance with the Common Agricultural Policy. On the other hand, the high standards imposed by the EU will be difficult to meet for many farmers and many farms are liable to fail.

Services account for 56 percent of GDP (The Economist Intelligence Unit 2007a). This sector includes the banking and financial services, retail and transport. The Romanian banking sector is competitive although characterized by a high degree of concentration with the first five banks holding more than 60 percent of banking assets (Baicu 2005). The banking sector has seen significant international investment with 31 of the 38 banks majority foreign-owned. All Romanian state-owned banks, with the exception of the Savings Bank\textsuperscript{20} (CEC), were privatized and some of these rank among the top foreign acquisition deals in Romania (Baicu 2005).

Retailing is another economic sector that is growing rapidly (Euromonitor 2006). Romania recorded the highest rate (26 percent) of retail sales growth in Europe during 2006. The sector is expected to continue to grow by ten percent per annum between 2007 and 2011, according to Jones Lang LaSalle (Leshtarska 2007). The interest in retailing has fueled foreign investment in this sector which reached 900 million euro in the first nine months of 2007 (ibid).

18 Romania was the only country where employment in agriculture increased during the 1990s (Maniu 2006).
19 \url{http://www.ice.gov.it/rapporti/pdf/romania.pdf}
20 The privatization of the Romanian Savings Bank was postponed indefinitely.
Because of insufficient investment and maintenance, Romania’s current transport infrastructure lags far behind Western Europe. Total traffic has increased by 60 percent on the major Romanian highways and international traffic by about 300 percent between 1990 and 1999. However Romania’s road network is totally inadequate to handle this increased traffic. Of the 198,817 kilometers of roads in Romania, only 60,043 kilometers are paved. As of January 1, 2007 there were some 285 kilometers of motorways in use although there are plans to build a further 1000 kilometers more by 2013, including two motorways to connect Bucharest to Hungary. The railroad system in Romania included 22,298 kilometers of track of which 36 percent is electrified and 27 percent is double-tracked (World Bank 2006). However, since 1989 railways have experienced a dramatic fall in freight and passenger volumes due mainly to the competition from road transport (ibid). A fraction of the freight and a small number of passengers are transported on waterways. The poor state of the road and rail infrastructure is likely to influence the geography of FDI with investors likely to prefer sites nearer to the western borders in order to minimize the use of Romania’s land transport infrastructure.

Romania has several ports on the Danube River and the Black Sea and a system of navigable rivers and canals connects the Romanian port of Constanta at the Black Sea to Rotterdam in the Netherlands. Air traffic has also increased considerably in the last 17 years and of the 17 main airports in Romania twelve are international.

21 http://www.factbook.net/countryreports/ro/Ro_EcoTrends.htm
24 The share of rail transportation fell from 80 percent in 1960 to 40 percent in 2001 for freight and from 70 percent to 50 percent for passenger travel in the time frame (World Bank 2006).
Chapter 2: THEORIES OF FDI WITH SPECIAL REFERENCE TO CENTRAL AND EASTERN EUROPE

The purpose of this chapter is to review the literature on FDI, with particular reference to Central and Eastern Europe. I begin this chapter by reviewing the major theories of FDI and examine the literature on the determinants of FDI. In the last part of this chapter I discuss the impact of FDI on national and local economies looking at both positive and negative effects. Finally I focus on one of the desired effects of FDI elaborating on the concept of embeddedness.

2.1 Theories of FDI

The first theories of FDI were developed by Stephen Hymer and Raymond Vernon in the 1960s. Previously, FDI was understood in terms of trade. A major assumption was that markets are characterized by perfect competition or that “firms produce homogenous products and enjoy the same level of access to factors of production” (Morgan and Katsikeas 1997: 70). According to this view, capital was believed to flow from one country to another based on differences in real interest rates (or profits) (Hennart 2001). The acceptance of this view by most economists in the 1950s and early 1960s was based on the observation that, in the 1950s, American companies were more profitable in Western Europe than in their home country (cf. Andronic 1999).
Hennart (2001: 129) argues that this theory had major flaws when applied to FDI. Most importantly, studies have failed to find a close match between FDI flows and the growth of multinational enterprises (MNEs). Empirical studies have shown that foreign branches are often established with loans from host country banks or banks situated in countries other than the MNE’s country of origin, and they grow by reinvesting the profits made in the host country (Marin and Schnitzer 2006). Therefore, “differences in real interest rates provide neither a necessary nor a sufficient reason for the existence of MNEs” (Hennart 2001: 129).

In the 1960s several scholars started to question the assumption of perfectly competitive markets as the environment in which FDI takes place. For example, Kindleberger (1969: 13) stated: “For [foreign] direct investment to thrive there must be some imperfection in markets for goods or factors […], or some interference in competition by government or by firms which separates markets.”

Scholars from a wide variety of disciplines have tried to explain the internationalization of economic activities assuming imperfect markets. Some of the earlier theoretical approaches in the 1960s and 1970s were rather adaptations of existing theories explaining other economic processes or phenomena. Among these are the industrial organization theory\textsuperscript{25}, the product life cycle theory\textsuperscript{26}, the

\textsuperscript{25} The industrial organization theory, one of the first theories seeking to explain the internationalization of economic activity through market imperfections was developed by Stephen Hymer in the 1960s and later by Kindleberger (1969) and Caves (1971). His approach focused on a firm-specific rather than a general-system view (Dicken 2003). Hymer (1976) drew his ideas from industrial organization theory and especially the notion of barriers to entry. He noted that, under normal conditions, domestic firms had an important advantage over foreign firms. Foreign companies have to compete with domestic enterprises in a business environment they are not familiar with and have to adapt to different legislative and regulatory conditions. Thus, investing abroad comes with certain costs and the decision to invest abroad is reached only when the advantages outweigh the costs. Among the main disadvantages of operating in an unfamiliar market are: lack of knowledge about local traditions and customs, as well as local tastes, a different legislative and
behavioral thesis and portfolio theory. According to these theories, FDI takes

institutional system, differences in the social and business behaviors and added operating costs due to distance. The primary assets that work in favor of foreign firms can include the size of the firm, the capacity to generate economies of scale, its market power and marketing skills, technical expertise or access to cheaper sources of finance (Hymer 1976). These advantages could eventually overcome the risks of operating in an unknown environment. However, while the theory has considerable merit it also has significant limitations (Calvet 1981). While Hymer’s work explains how and why firms start to internationalize it fails to account for their subsequent development having established an international position (Dicken 2003: 203).

In contrast to Hymer, Raymond Vernon used the concept of the product life cycle to explain international production (Dicken 2003). The main idea and the starting point for Vernon’s theory is that new products always reflect the characteristics of the domestic market (Vernon 1966). Vernon does not use this term, but today we could say that new products are embedded in their domestic or local market. Using the example of the United States Vernon argued that in the first phase of the product cycle, all production is concentrated in the U.S. while international markets are served by exports (Vernon 1966). In time, however, especially as international demand increases, some production facilities are transferred abroad to save on production or distribution costs or to bypass tariffs or other trade barriers. Initially American companies would set up production facilities in developed countries, which would also serve neighboring markets. Later, more branches would be opened in other, less developed areas, and eventually in those of the third world. In the last phase, production would be completely removed from the United States and other developed countries to third world states and the U.S. market would then be served by imports produced by US firms (Vernon 1966). When this theory was formulated in the 1960s, it seemed to provide a reasonable explanation of the locational evolution of TNCs. However, today this simple evolutionary sequence is seen as unrealistic by most scholars because we have no reason to assume that innovation and initial production could not start at any point within the firm’s global network (Dicken 2003). Moreover most foreign direct investment takes place between countries of similar economic status rather than between developed and less developed economies (Dicken 2003).

Aharoni’s (1966) work on the foreign investment decision process expanded on earlier work by Cyert and March (1963) on the behavioral theory of the firm. Aharoni argued that managers’ decision to invest abroad is strongly influenced by uncertainty. Due to scarcity of information about possible host countries, managers tend to exaggerate the risk and the uncertainty of foreign investments. In order to avoid uncertainty, firms tend to stick to the “business recipe” that made them successful (Cyert and March 1963). Therefore, in order for foreign investments to materialize there must be some initial force that encourages management to consider foreign direct investment. This force could be internal, determined, perhaps, by crisis within the organization, or external. The latter may take the form of an invitation from the government of another country, from their own distributors in that country or simply in the form of a sharpening competition that threatens the position of the company on domestic and international markets. Once the decision to invest abroad is taken, the realization of the investment projects depends on the firm’s capacity to acquire the necessary information about the location.

Rugman (1979) argued that firms invest abroad in order to minimize risks. His work indicated that “stability of earnings through time is an increasing function of the ratio of foreign to total operations” (Rugman 1976: 75). By investing in several economies, firms are more likely to reduce the risks associated with economic fluctuations, provided that these fluctuations are not positively correlated for all countries in which the firm has invested. Diversification can occur horizontally, vertically or in a conglomerate fashion (Agmon and Lessard 1977). However, the theory fails to explain why firms prefer foreign direct investment to portfolio investment. Ragazzi (1973) has tried to clarify this by arguing that many developing countries are characterized by imperfections in securities markets (such as legal restrictions, capital controls, currency controls, prohibitive tax regulations as well as difficulties with processing information). According to Ragazzi, these barriers to the flow of portfolio capital alone may motivate FDI. Still, the theory does not explain why some industrial sectors have internationalized more than others (cf. Andronic 1999).
place when firms accumulate advantages that would outweigh the cost of operating in a foreign, unknown market (Hymer 1976) or when there is an internal or external force that pushes companies to expand abroad (Aharoni 1966; Rugman 1979).

However, while these theories have provided some interesting insights on the mechanism of foreign direct investment, they also have important shortcomings. Some of these theories can account for the initial foreign investment but cannot explain subsequent investments of the firm (Hymer 1976). Others assume that FDI flows follow certain patterns, for example from developed countries to developing countries (Vernon 1966). Others cannot explain why firms would prefer direct investment to other forms of internationalization (Rugman 1976, 1979).

The latter question is answered by the proponents of the internalization theory or the transaction cost theory. The main proponents of this approach are Buckley and Casson (1976), Williamson (1975), Hennart (1982; 2001) and Rugman (1981; 1996). The internalization thesis is based on the theory of the firm enunciated by Coase (1937) and subsequent location theory (cf. Williams 1997). Coase believed that increased transaction costs led firms to own complementary assets rather than contracting them in the open market. Firms thus internalize their externalities and reduce their transaction costs.

Buckley and Casson (1976) applied this theory to explain the internationalization of the firm. The starting point is one of market imperfections arising from the “bounded rationality” and the “opportunistic” character of economic agents (Hennart 2001). Buckley and Casson (1976) focused on imperfections in intermediate product markets, including various types of
knowledge and expertise. For example, know-how developed by a company in a country is potentially useful to companies in other countries and, in perfect markets, could be transferred at a low marginal cost. However, in reality markets suffer from information asymmetry (Hennart 2001). Both the seller and the buyer are suspicious when exchanging know-how. The buyer would like to know the exact character of the product while the seller cannot offer that information without risking the free transfer of knowhow. Licensing is not always a solution because the know-how may include considerable tacit knowledge which cannot be easily patented. The transfer of knowledge from one country to another within the same company is thus seen as a more effective strategy.

Buckley and Casson (1976: 35) see the MNE as an “international intelligence system for the acquisition and collation of basic knowledge relevant to R & D [research and development] and for the exploitation of the commercially applicable knowledge generated by R & D.” Internalization/transaction costs theory is one of the most popular theories that explain FDI. Indeed Rugman (1981) claims that all theories of FDI are variants of one form or another of internalization theory.

Most theories of FDI assume that foreign direct investment is based on the rationale of maximizing profits. Internationalization theory, in contrast, centers on the process of human decision making. The internationalization process model is rooted (cf. Meyer 1998) in two earlier theories: the behavioral theory of the firm developed by Cyert and March (1963) and Aharoni (1966) and the growth theory of the firm developed by Penrose (1959).
The internationalization process model developed by Johanson and Vahlne (1977; 1990; also in Johanson and Wiedersheim-Paul 1975) stated that, as a determinant of FDI, physical distance between home and host country is less relevant than psychic distance, a term first used by Beckerman (1956; cf. Meyer 1998) to include cultural and linguistic communalities between home and host economies. According to this theory, firms start their internationalization in countries that are closest in psychic terms to the country of origin. They may then choose to enter more distant markets as they gather more information about them.

Pedersen and Shaver (2000) take issue with the gradual and incremental character of the internationalization process. They argue instead that the internationalization process should be characterized in step-wise fashion with a longer initial time period for the first investment and much shorter time periods between subsequent expansions. According to Meyer (1998: 77), the relative importance of psychic distance has declined after the 1970s and economic conditions appear to have become more important in the literature, especially industry specific barriers to entry, market potential and industry structure.

As mentioned earlier many of these theories build on each other or are complementary. Each of these theories seems to answer one or two questions while leaving other questions unanswered. The theory that tried to cover all facets of FDI is the eclectic theory. Formulated by John Dunning (Dunning 1980; 1993; 1995; 1996; 2002; Dunning and Narula 1996), the eclectic theory is a blend of different theories on FDI circulating in the literature. It is also known as the OLI paradigm.
where each letter (O + L + I) designates a type of advantage that added together determines whether a company will invest abroad or not.

1. O stands for ownership advantages (or firm specific advantages). The company must posses certain competencies and assets (e.g., technology, brand name, monopolistic advantages) that will allow it to overcome the costs of operating at a distance and in a different country and to compete successfully with domestic firms. These advantages must allow foreign companies either to earn more at comparable costs or to have the same revenues as domestic firms but at lower costs.

2. L refers to location advantages (or target country specific advantages) and can be broken down into three categories: economic, social, and political. The costs of operating in that country (market size, labor costs and quality, transportation costs, etc.) represent the economic advantages. The socio-cultural aspect is more complex and includes: general attitudes of population towards foreigners, language, cultural match between the investor’s country and host country, and perceived distance between home and the host country. Political factors refer to central and local government policies that could influence inward FDI flows.

3. Internalization advantages (the I in the OLI paradigm) determine how multinational enterprises venture abroad. This can happen through exports, licensing, franchising, minority joint venture, or wholly owned subsidiaries. The MNE weighs the benefits and the costs of entering a foreign market through each of these modes and selects the most profitable. The company will choose to
internalize its production when this is more advantageous than exporting or licensing.

Dunning’s eclectic theory is based on three sets of economic principles (cf. Dunning 2000: 26). The first is the theory of industrial organization, the base for Hymer’s theory. The second is the theory of the firm, which explains the organizational mode by which firms create, augment or use their competitive advantages. The third component is location theory, which explains where firms choose to locate their value-added activities. Dunning’s eclectic theory has the merit of harnessing a variety of explanations of foreign direct investment to form one, all-encompassing account. However, this is also the main criticism of the theory. Critics argue that it is nothing more than a collection of factors and that the theoretical relationships between the different factors are insufficiently theorized (Taylor and Thrift 1986:12; Rivoli and Salorio 1996; Grosse and Behrman 1992). Grosse and Behrman (1992: 117-118) argue that each component of the three-part theory is “market-oriented and firm-based, focusing on economic criteria of efficiency” while non-economic interactions between governments and companies or among governments are ignored or underemphasized.

As mentioned earlier, the human factor is also important. The proponents of the internationalization theory have shown that foreign companies often invest in certain countries due to historical or cultural ties rather than economic efficiency. Also often foreign investors act not because they see an advantage investing abroad but rather because they sense a problem if they do not invest. This view is captured
in the Oligopolistic Reaction Theory\textsuperscript{29}. A further shortcoming of all these theories, including the eclectic paradigm is the assumption that firms create (or acquire) their assets in their home countries before expanding abroad. This finding has been refuted by a number of empirical studies (Dunning 2000: 28).

In this study I follow Dunning’s eclectic theory as being the most comprehensive of all FDI theories, while the internationalization theory and the oligopolistic theory could be seen as complementary. However, while ownership and internalization advantages are important factors in examining FDI, geographers have tended to focus on the location advantages. In the next section I will review the expansive literature on locational determinants, focusing primarily (but not exclusively) on geographical determinants operating at national level. I am also concentrating on Central and Eastern Europe, therefore some determinants which may be important for other regions (like natural resources) are not important for Central and Eastern Europe (except for a few countries like Russia and Azerbaijan) (Toendel 2001; Campos and Kinoshita 2003) and will not be discussed here.

\textsuperscript{29} Presented initially by Knickerbocker (1973), this theory postulates that an initial investment made by a leading company in a country will be followed by similar investments by other oligopolistic firms. This “follow-the-leader” reaction is a form of risk minimizing behavior “made to prevent a competitor from accumulating new capabilities, information, markets and competitive options through DFI” (Flowers 1976: 43; Knickerbocker 1973). The risk of entering an unknown market is seen as preferable to leaving a competitor to operate (and possibly expand) alone in that particular market. This theory (at least partially) explains the clustering of foreign direct investment projects in certain locations. A variation of this pattern was theorized by Graham (1978). Researching European FDI in the United States, he noted that many investments were “retaliations” for U.S. investments in Europe. Graham argued that by investing in Europe, American companies intensified competition in European markets thereby squeezing profits. This had a lesser effect on U.S subsidiaries because their parent companies were able to maintain prices and profits at home. The subsequent investments by European firms in the U.S. market were meant to neutralize the competitive advantage of U.S companies through an “exchange of threats”. While the oligopolistic reaction theory provides a reasonable explanation for complementary flows of FDI, it fails to explain the initial investment abroad.
2.2 Locational Determinants of FDI

Since the 1960s, a wide range of studies have investigated the location determinants of foreign direct investment (Pickernell 1998; Walkenhorst 1998; Pantulu and Poon 2003; Meyer 2001; Bradshaw 2002; Barski 1995). Most of them have centered on economic factors. From this viewpoint, FDI can be either resource-driven (when the foreign company invests in order to tap into a cheap resource, such as mineral resources or labor) or market-driven (in which case the foreign company intends to sell its products on the domestic market). In many cases, FDI is driven by a combination of the two. The main economic and non-economic factors that determine flows of inward FDI can be synthesized as follows:

2.2.1 Political and Business Environment

Economic and political stability are preconditions for significant foreign investment (van Hastenberg 1999). The political instability that characterized Slovakia, Romania and Bulgaria in the 1990s could, at least partially, explain why these three countries had received less FDI than Latvia and Lithuania (Dyker 2001). The intensity and direction of FDI are also influenced by national and local authorities’ attitude toward foreign investment. Bandelj (2001) argued that what shapes patterns of FDI are not so much economic potential and country risk indicators, but rather state policies: “Post-socialist states’ decisions to sell large state monopolies to foreigners significantly shape the FDI trajectories across countries over time, creating turning points in the series” (Bandelj 2001: 3). Bandelj challenges prior research based on the neoliberal assumption that investment sites are selected to
maximize profitability, arguing that “institutional arrangements significantly
determine the FDI trajectories in Central and Eastern Europe”. Politics and culture
are, as noted above, also important in structuring economic exchange (Bandelj
2001: 6).

Many studies have approached the question of barriers that inhibit foreign
investments. Barski (1995) and Bradshaw (2002) explained the low interest of
foreign investors in Russia in terms of the lack of support from federal and regional
governments and hostility of many Russian politicians and entrepreneurs towards
foreign investments. Other problems include the high tax burden and unfair
taxation, an economic system that is poorly adapted to the western standards and
Russia has been unable to attract foreign investors into its forest industry. The main
impediments to FDI were identified mostly in the political and institutional realm:
an ambiguous legal system, difficulties in negotiating with local authorities, unfair
tax enforcement as well as general political instability. These obstacles kept many
investors away despite the country’s attractive resources and the size of its potential
market. Gligorov (2001) argued that low inward FDI to the Balkan countries could
be explained by the barriers and restrictions that operate in this region, some of
them imposed by other countries (such as the trade embargo on Yugoslavia in the
mid 1990s), others self-imposed and some inherited.

Among these barriers, corruption is, along with political and macroeconomic
instability, a major concern for foreign investors (Bitzenis 2003). One way of
evaluating the level of corruption in a country is by using the corruption perception
index (CPI) published annually by Transparency International. Scores between 1 and 10 are assigned where 1 represents the highest corruption. In the 1990s, Slovenia and Estonia (with a CPI between 5.5 and 6) had the lowest perceived level of corruption in Central and Eastern Europe whereas Armenia, Russia and Albania (CPI between 1.5 and 2.3) were perceived among the most corrupt (Toendel 2001). In the same document, Romania had a CPI of 3.2. This is why, McGee (2003) argues, the existence of a rule of law and clear legislation is necessary to attract foreign companies. Foreign investors also need assurance that property rights are defined and guaranteed. As McGee (2003) indicates, funds do not necessarily flow to where they are most needed, but rather to where conditions are best for investment.

Attitudes towards FDI are reflected not only in these “barriers” but also in the incentives governments have offered to attract foreign investors. These monetary and financial incentives are often offered to attract larger investments or for those directed to areas with high unemployment. These incentives take different forms, including tax holidays. For instance, in Estonia incentives are aimed to encourage foreign companies to shift their investment from the capital to more remote regions (Paas and Scannell 2001). Estonia is also attractive for foreign investors because its flat rate tax of 26 percent applies to both personal and corporate income (Paas and Scannell 2001). Besides that the country has no tariffs which promotes open trade and is seen to treat Estonians and foreigners alike in business matters (Thompson 2000). In order to attract multinational corporations in the automobile industry, Hungary, a country with a small market and economic
weaknesses, offered unusually generous tax holidays in the 1990s and profits repatriation allowances (Bartlett and Seleny 1998).

Various studies have argued that the degree of macroeconomic stability in a country is of paramount importance for foreign investors (UNECE 2001; Lankes and Stern 1998). Clear and stable policies, promotion and protection of private ownership, and efficient financial markets are seen as especially important for attracting FDI. Higher FDI flows in the 1990s to countries like Hungary, Czech Republic and Poland than to those further east reflect earlier economic reforms starting even before 1989 and continuing at a faster pace after 1990 (Kinoshita and Campos 2002; Lankes and Stern 1998).

One aspect of economic reform that has proven particularly important in the transition economies is privatization. The speed of the privatization process and the method selected for privatization are seen to be relevant to explaining FDI (Merleverde and Schoors 2004; Aghion and Blanchard 1994). Countries in which the privatization process is more advanced have generally attracted more FDI, whereas others like Romania in which the privatization process advanced slowly in the 1990s, have been less favored destinations (Popescu 1999; Ahrend and Oliveira Martins 2003; UNECE 2001).

The method of privatization chosen is also important (Schwartz and Haggard n.d.). Some countries including Russia and other former Soviet republics preferred insider privatization in which companies were sold to managers and employees. This type of privatization has attracted few foreign buyers as both managers and employees have been reluctant to sell to foreign investors fearing the loss of
privileges and jobs. The Czech Republic and, to some extent, Romania have used voucher privatizations (Popescu 1999) in which all citizens over the age of 18 received vouchers which could then be exchanged for shares in a privatizing company of their choice (Pavlinek 2002c). While foreign investors could easily buy shares from new private owners, the process was, in some cases slowed by the high number of shareholders that resulted from privatizations of this form. The privatizations associated with the greatest FDI flows have been direct sales in which state enterprises are sold to the highest bidder (Zakharov and Kusic 2003). Hungary has generally followed such a model (Williams et al 1998). Strategic investors were preferred in the case of the largest companies, while medium-sized companies were sold to the highest bidder. In this way governments gain immediate access to foreign capital and new owners engage in significant restructuring (Spiro 2004). Hungary was most successful in the early stages of privatization (1990-1994) with foreign direct sales amounting to the equivalent of 10% of GDP in 1994 (Williams et al 1998).

2.2.2 Labor

Labor costs are often cited as a major incentive for investing in Central and Eastern Europe (for example Walkenhorst 1998; Csaki 1995; Meyer 2001; Martin and Straubhaar 2002; Voinea 2002; and others). Even when considering the lower productivity of labor in Eastern Europe wages remain very competitive (Bevan and Estrin 2000; UNECE 2001). Not only is the cost of labor important for foreign investors but so is labor quality (Kinoshita and Campos 2002). Indeed, especially in
the 1990s foreign companies that decided to invest were lured by the qualified and cheap labor. Some studies have downplayed the importance of labor costs considering it at best a secondary or minor factor (Meyer 1998; Resmini 2000). As a general rule, labor costs seem to be more important for those companies that invest in labor intensive industries (van Hastenberg 1999) or in certain “core” industrial sectors such as metal products, mechanical products, electrical and electronic equipment (Altzinger 1998). Perhaps even more important than the cost of labor is, in many cases, the availability of labor, as well as the presence of flexible employment legislation and good industrial relations (Collis et al 1999).

2.2.3 Size of the Host Market and Potential

Analyzing the sale and trade patterns of Austrian affiliates in CEECs, Altzinger (1998) noted that two thirds of overall output was sold on local markets which led him to conclude that market driven factors are dominant for Austrian investments in neighboring countries. These conclusions are shared by Meyer (1998) and Resmini (2000) who each showed that Italian investments are concentrated in three of the largest economies in the region. The size of the market is therefore an important factor in determining the location of FDI. Large countries with potential for development are generally favored over smaller counterparts. Bradshaw (2002) notes that, although small when compared to GDP, foreign investment in Russia is mostly market driven. Moreover, mapping the geography of FDI in Russia, Bradshaw (2002) notes that most foreign capital is destined for Moscow (with a population of over 10 million) and other regional centers such as St. Petersburg,
Samara, Sverdlovsk and Novosibirsk representing the main centers of production and consumption. However, in addition to population average incomes and/or the potential to increase these incomes are seen as important determining factors (Merlevede and Schoors 2004). When “barriers” preclude companies from investing directly in countries with large internal markets they settle for smaller neighboring countries that have advantageous trade agreements with the target countries. For instance, Johansen et al (2000) argued that the main reason for Nordic companies to invest in the Baltic region, where they are faced with harsh (“Klondike-like”) conditions, is the huge potential represented by the nearby Russian market. Similarly, Slaveski and Nedanovski (2002) have contended that, in many cases, Greek investors see Bulgaria and Macedonia (transition countries in the Balkans characterized by political instability, low intra-regional trade and small national markets) as a bridge to the larger markets of CIS and Yugoslavia respectively.

2.2.4 Geographical Proximity

Logic dictates that geographical proximity is a major determinant for foreign investment. By investing closer to their home countries, firms minimize transportation costs and delivery times (Schwartz and Haggard n.d.). From this perspective the countries in Central and Eastern Europe most successful in attracting FDI are those nearest to Western Europe (Resmini 2000), while Balkan countries receive far less investment, although here too proximity determines the main recipients (Slaveski and Nedanovski 2002). From a sectoral point of view,
geographical proximity may be more important for certain industries than for others\(^3\) (Walkenhorst 2001; Jansik 2004).

### 2.2.5 Psychic Distance

Although largely ignored in neo-classical economic accounts (where social relations between actors are treated as no more than frictions obstructing competitive markets - Grabher 1993a) non-economic factors are seen by some as critical in influencing the flow and direction of FDI. Buckley and Casson (1976) noted that not only geographical distance but also the existence of dissimilar environments leads to an increase in communication costs. By dissimilar environments the authors refer to different social and economic conditions as well as different languages. Due to these economic, cultural and social differences, communication between “encoders” (those who transmit information) and “decoders” (those who receive information) is more difficult, with misunderstanding requiring additional firm spending.

Several other studies emphasized the importance of cultural affinities between investors and host countries in determining FDI (Altzinger 1998; Martin and Straubhaar 2002; Paas and Scannell 2001; Johansen et al. 2000; Bandelj 2002; Yeung 1994; Yeung 2000; Kogut and Singh 1988; Helliwell 1999; Van Bergeijk 1996; Bellak 1997; Meyer 1998 and others). For instance, in the case of Austrian FDI, Altzinger (1998) found that in 1995, the four adjacent countries (Czech

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\(^3\) Walkenhorst (2001) found that in the Polish food industry foreign companies involved in staple foods are more sensitive to distance than companies in high value-added branches like confectionery, beverages or tobacco which are generally more globally sourced.
Republic, Slovakia, Hungary, and Slovenia) received more than 91 percent of Austria’s overall investment in the Central and Eastern Europe. His explanation rests on the importance of spatial proximity for Austrian investors and the existence of cultural and historical ties with neighbors that less than a hundred years ago were united in the Austro-Hungarian Empire. Paas and Scannell (2001) and Johansen et al (2000) highlighted the preference of Nordic investors companies for the Baltic States. Again, one might interpret this not only as a matter of geographic proximity but also a revival of long-standing historical and cultural ties.

Bandelj (2002) analyzing flows of FDI in Central and Eastern Europe found that political, migration, trade, and cultural relations between investors and hosts have strong positive effects on FDI flows. She argues that agents of investment prefer FDI transactions that follow previously established personal and business ties to rather than those guaranteed by formal institutional channels. Not only do investors choose the country of their investment based on cultural, ethnic, or language affinities but decision takers in host countries may similarly favor investors from ‘like’ countries. For example Slovenians’ sympathy towards Germans and Austrians whom they consider “precise, orderly, [and] trustworthy” generates a preference for FDI from these countries. Bandelj finds that Slovenians are more suspicious of Italian investors whom they perceive as “unreliable” and who get things “messied up.” American investors, on the other hand, are seen by Slovenians as “arrogant” and with little regard for employees (Bandelj 2003: 386).
2.2.6 Agglomeration Economies

The foreign companies that initially invested in the more advanced transition economies signaled good local conditions for foreign investors which, in turn, had a “snowball effect” on FDI, as the initial clusters attracted additional foreign investors (Kinoshita and Campos 2002; Boudier-Bensebaa 2005). There are two explanations for this. Firstly, foreign investors tend to “herd” naturally especially when they have limited information about host country conditions (Kinoshita and Campos 2002: 3; see also Knickerbocker 1973). A second explanation points to the advantages of agglomeration economies, including knowledge spillovers, specialized labor markets and supplier networks (Porter 1990; Ivarsson 1999; Szanyi 2001). Kinoshita and Campos (2002) found that agglomeration economies may be the most important determinant of inward FDI in the transition economies of Central and Eastern Europe.

2.2.7 Affiliation to a Regional “Bloc” (real, imminent or perceived)

Empirical studies have shown that a country joining the European Union is liable to benefit from increased flows of FDI from EU and non-EU members (de Sousa and Lochard 2004; Merlevede and Schoors 2004; Bevan et al 2001; Dyker 2001). By joining a regional bloc, like the EU the market for goods or services produced in an accession country expands as trade barriers are removed (Kaminski 2001). The anticipation of regional integration alone is sometimes sufficient reason to cause additional inward FDI (UNECE 2001). The accession process exerts pressure on governments to proceed with economic reform especially since candidate countries
have to align their economic and institutional systems with that of the EU. Moreover, “Integrationist accords, […] enhance credibility of the government in a transition economy in terms of commitment to economy-opening reforms” (Kaminski 2001: 27). While EU membership or anticipation of membership represents an important factor in explaining differences in inward FDI between the ten Central European member states and some former Soviet Republics, it cannot provide an explanation for the large variation of FDI flows among these member states and over time (Kaminski 2001: 31). In some cases the mere perception of a country being part of a certain group could constitute an advantage or a disadvantage. Balasubramanyan and Corless (2001) for example, analyzed the degree to which the perception of one country belonging to a regional grouping influenced inward FDI flows. Their results indicate that, in the 1990s, Poland, Czech Republic and Hungary operated a much more liberal regime than other countries in Central and Eastern Europe, exhibiting a much more stable macroeconomic environment and possessing substantial amounts of human capital. Foreign investors perceived “the bloc” formed by these three countries as attractive for FDI.

The situations in which only one factor determines the flows of FDI to a country are unusual. Indeed, the consensus in the literature is that a range of factors are likely to be important in explaining the extent and nature of inward FDI (Collis et all 1999), while barriers serve to limit the intensity of inflows.

After seeing why companies are investing abroad and what are the criteria they use to decide on the country and/or site of their investment the next question is
why countries want to receive FDI. What are the positive as well as the negative effects of FDI on the host countries? In the next section I will analyze the extensive literature on the impact of FDI on host economies paying particular attention to the issue of embeddedness.

### 2.3 Impact of FDI on host economies

The impact of FDI on host economies can be broken down into direct effects, indirect effects and wider effects (Potter et al. 2002). Direct effects relate to activities taking place within the local facilities of the foreign investors, and include their direct output and employment. Indirect effects relate to activities created by the local presence of foreign facilities but which impact beyond the firm itself. This refers to activities supported in other enterprises by the purchasing and sales linkages of foreign subsidiaries and through the local spending of wages and salaries by those working for foreign-owned firms. Wider effects relate to additional impacts that come about through changes in the strategy, practices and competitive advantage of domestic firms as a result of the presence of foreign investors. Both positive and negative effects of FDI have been identified in the literature, although the general consensus in the case of Central and Eastern Europe is that positive effects have generally outweighed the negative (see Jansik 2004).

**2.3.1 Capital Investment**

By definition foreign direct investors bring in capital to a host country, which unlike foreign borrowing does need not to be repaid. This capital can be used to repay
foreign debt and sustain government spending (Mihalyi 2001). The importance of FDI for the Central and Eastern European economies is demonstrated by the fact that in these countries FDI represents 44 percent of total fixed capital formation while in the “developed economies” it accounts for between four and 17 percent (Bevan et al 2001: 4).

2.3.2 Technology Transfer and Spillover

Foreign investors are seen to have played an important role in replacing old, outdated and largely inefficient technologies in state-owned enterprises with new, modern and competitive counterparts. Moreover, studies have shown that technology used by foreign affiliates spills over to domestic companies, especially in the more advanced transition countries in Central Europe (Damijan et al 2001). According to Sinani and Meyer’s (2002) study, the magnitude of the spillovers is dependent on the foreign investment and on the size of the recipient company, its ownership structure and trade orientation. Additionally strong competition has a beneficial effect on spillovers, as domestic companies are pressured to either become more efficient using their existing technologies or adopt newer ones. While positive technology spillovers are clear studies suggest that they tend to be spatially confined and are more evident in industries in which the technology gap between the foreign and domestic companies is small (Jones and Wren 2006).
2.3.3 Transfer of Technical and Managerial Know-How

FDI not only brings needed capital and new technology but also the transfer of technical and managerial know-how to host country firms (Hardy and Smith 2004; Nowak and Steagal 2001). Effective transfer of Western technical and managerial know-how may be the most important consequence of FDI to the formerly communist countries of Central and Eastern Europe (Hardy 1998). Unlike other world regions with high FDI inflows such as Southeast Asia or Latin America the Central and Eastern European countries inherited an educated labor force but outdated technology as well as managerial and organizational forms along with marketing and advertising practices that were firmly rooted in an uncompetitive economic system (Fabry 2000). In order to build efficient affiliates, Western companies “have to transfer not only their own corporate values and management rules but also the Western conception of the firm” (Fabry and Zeghni 2003: 134). Knowledge transfer can take several forms including knowledge embedded in patents and trademark in the specific way in which firms organize their marketing and financial practices, as well as in work organization and product innovation management (Fabry and Zeghni 2003; Pavlinek and Smith 1998; Sadler and Swain 1994). Particularly important in transferring the competitive advantage of parent companies to affiliates is the effective transmission of tacit knowledge (Maskell and Malmberg 1999). Training of managers and workers to Western technical and managerial standards is done both on the job and off the job in the form of formal schooling, seminars or visits from or to the parent firm (Fabry and Zeghni 2003; Szalavetz and Luecke 1997). The Italian car manufacturer, Fiat for example, spent
4.3 million euros in 1993 and 1994 alone to train its managers and workers in Poland. Programs ranged from technical updating to teamwork building designed to instill basic “Fiat values” (Haanes et al 1997; in Worral et al). Spillovers can occur through three channels: demonstration effects, labor turnover and vertical linkages (Saggi 2002). The new competition from multinational corporations puts pressure on local firms to “reinvent” themselves. They can do so by adopting new technologies and imitating Western firm practices (also in Blomstrom and Kokko 1998; Blomstrom et al 2000). Knowledge can also be transferred by managers and employees who have previously worked and been trained by foreign firms and who use their newly acquired skills when hired by a domestic company. And finally, multinational corporations often have an interest in transferring technology and know-how to their suppliers or customers.

2.3.4 Economic Productivity

Evidence suggests that foreign-owned companies in Central and Eastern Europe tend to be more productive than domestic-owned companies and that the privatization of formerly state-owned enterprises to foreign investors typically results in improvements in the performances of these firms (Weiss and Nikitin 2001; Uminski 2001; Djankov and Hoekman n.d.). Whether this productivity increase is transferred to domestic companies is a matter of some dispute. For instance, Djankov and Hoekman (n.d.) found no evidence of productivity spillovers from foreign affiliates to domestic companies, while Smarzynska’s (2002) study of FDI
in Lithuania found productivity spillovers to domestic suppliers but not to competitors.

Another conclusion of the latter study was that foreign companies oriented to domestic-markets are more clearly associated with productivity spillovers than those geared to exports. The reason is likely due to the embeddedness of the former in local economies, while the latter are more commonly tapping into cheap resources (including labor) in the host country. Konings (1999) investigation of the effects of FDI on the productivity performance of domestic firms in three countries: Bulgaria, Romania, and Poland revealed few if any spillovers to domestic companies in Romania and Bulgaria while in the case Polish case FDI caused negative spillovers to domestic firms. In Romania and Bulgaria this was seen as the consequence of domestic companies having “outdated and old equipment, with no or little room for R & D and innovation and hence the absorptive capacity of domestic firms might be limited”. The negative competition effect affecting domestic enterprises is the most likely explanation for negative spillovers in Poland (Konings 1999: 12).

2.3.5 Provision of Jobs and Higher Wages

Employment is also impacted by the flow of inward investment (Radosevic et al 2003; Swain 1998; Fazekas 2003). Radosevic et al (2003) argued that FDI has generally generated new employment or at least helped preserving existing jobs. However, we are warned that “at best FDI operate as a complement to, rather than a

31 However, the role of FDI in employment generation/preservation varies from country to country. For instance while in Hungary it has played a central role, in Estonia it has been less successful in generating/preserving jobs (Mickiewicz et al 2000).
substitute for, domestic employment generation/preservation” (Radosevic et al 2003: 84).

A further conclusion of this study is that export-oriented FDI generates more employment than market-oriented FDI. As noted above, in foreign-owned firms labor productivity is generally higher than in domestic-owned companies. In Hungary and Czech Republic, for example employees of foreign companies are twice as productive as workers in domestic companies (Hunya 2000; Zemplinerova 1998). Barrell and Holland (2000) showed that FDI increased labor productivity in eleven manufacturing sectors in Poland, Czech Republic and Hungary. Labor productivity increased less as a consequence of capital investment associated with FDI, and more as a result of intangible assets introduced by foreign companies.

The existence and amplitude of positive spillovers also depends on the type of FDI, on the size of companies and on the level of economic development of the host country (Vahter 2004; Yudaeva et al 2000). In boosting higher labor productivity, foreign-owned companies can afford to pay higher wages (Hunya and Geishecker 2005; Faggio 2001). Onaran and Stockhammer (2006), however, have argued that wages have increased much more slowly than labor productivity. Only in the capital and skill intensive sectors has FDI had a clear positive effect on wages. Faggio (2001) has identified higher wages spillovers to domestic companies in Poland, but not in Romania and Bulgaria.
2.3.6 Industrial Restructuring and Sectoral Transformation

By introducing new technology and a Western approach to business, by increasing economic productivity and by making formerly state-owned enterprises profitable, foreign investors have made an important contribution to industrial restructuring (Zemplinerova and Jarolim 2001; Rojec 2001; Szanyi 2001; Guerreri 1998; Zemplinerova 1998; Zemplinerova and Benacek 1997).

Furthermore, by agglomerating in certain industrial sectors in which a Central or Eastern European country has a comparative advantage and shunning those in which it does not, FDI may cause the (re) specialization of that country within more global divisions of labor. Pavlinek (2002a; 2002b, 2002c, 2000) demonstrated the impact of FDI on the car industry in Central Europe by comparing car manufacturers that received an infusion of foreign capital with those that remained in local hands. His conclusion was that without FDI the car industry would have collapsed.

2.3.7 Increase in International Trade

Two of the most important reasons why governments actively seek FDI are to substitute for imports, which can lead to serious budget deficits and second, to encourage exports (Gibb and Michalak 1994). The market-seeking MNEs that entered Central and Eastern European countries immediately after 1989 have fulfilled the first condition while resource-seeking foreign companies (especially those trying to capitalize on lower labor costs) are among the most active exporters. In general, foreign-owned companies have higher shares of export sales than
domestic counterparts (Hunya 2000). For instance, in the 1990s foreign companies accounted for 70 percent of Hungary’s exports while employing only 20-25 percent of its active workforce (Barta and Kovacs 1997).

Inward FDI is increasing Central and Eastern Europe’s participation in global networks of production and distribution, which is demonstrated by the rapid increase of trade-output ratios (Kaminski and Smarzynska 2001; Mencinger 2003). Sun (2001) and Sun and Parikh (2001) contended that inward FDI may stimulate exports from domestic sectors through industrial linkage effects, especially through backward linkages in other words, buying locally-made intermediate inputs to produce exported goods.

2.3.8 Contribution to Economic Growth

Whereas traditional theory claims that FDI could be the engine of growth for host countries, empirical studies show far less conclusive results (Carkovic and Levine 2002; Japan Bank for International Cooperation 2002). Padayachee (1995) distinguished four major approaches to the relationship between foreign capital and economic growth in developing countries, which he calls the neoclassical approach, dependencia school, bargaining approach and structuralist school.

The neoclassical view argues that the capital and technology embedded in FDI are a prerequisite for economic development. The dependencia school, on the other hand, warns of the risks and negative effects of foreign capital on economic growth. Importing technology for example, creates a dependence on foreign technology and know-how and a loss of national economic autonomy. Those in the
bargaining school argue that gains from foreign investments arise from prolonged negotiations between foreign interests and host countries. The structuralist approach is akin to the dependencia school and argues that “developing countries are more likely to suffer a long term decrease in the power, especially over high-tech manufacturing companies” (Padayachee 1995: 164).

Work in Central and Eastern Europe has tended to confirm that inward FDI has had a very positive impact on growth over the last ten years (Neuhaus 2006; 2005). Neuhaus calculated that FDI has contributed 2.3 percentage points of the 3.5 percent average growth rates, meaning that almost two-thirds of the growth in this region is attributable to FDI (Neuhaus 2005). The same data show that domestic investments explain little of the growth (Neuhaus 2005).

While the impact of foreign direct investment on economic growth is positive in all Central and Eastern European countries, its precise contribution varies between countries depending not only on the size of inflows but also each country’s capacity to absorb them. Countries that have the capacity to absorb investment flows quickly have experienced a larger impact on economic growth. Accordingly, countries with lower FDI inflows could have a better absorption rate (Neuhaus 2005). Exponential growth of FDI stock in Romania and the country’s positive absorptive capacity explain why in this case FDI has had the strongest contribution to economic growth among all Central and Eastern European countries. On the other

Meaning how prepared are host countries to process the new capital and knowledge entering the country with the foreign investors to benefit the development of the country. For example if they had the right institutions in place host countries could use the capital from the privatization of state enterprises to modernize the infrastructure or to invest in strategic industries and further attract more investors while at the same time contributing to the economic growth. Therefore foreign investment alone has a limited impact on economic growth unless the host country has the capacity to absorb the investment.
hand, the combination of slower growth rates for inward FDI and weaker absorptive capacity explain FDI’s lesser impact on economic growth in the more developed countries in the region, notably Czech Republic and Hungary (Neuhaus 2005).

### 2.3.9 Institution Bending

Hardy and Smith (2004) argued that in Central and Eastern Europe, the ‘institution bending’ effects of inward investors outweigh the direct economic and material benefits of foreign investments. Bending of institutional interests in favor of foreign investors and the direct creation of new institutional structures works to favor foreign interests over domestic counterparts.

In order to attract foreign investors and stimulate growth, policy makers seek to improve the investment climate (Neuhaus 2005). These efforts include investments in infrastructure, a commitment to privatization and deregulation and the creation of an attractive and stable legal framework. Foreign companies, on the other hand seek greater protections for private property and the introduction of international accounting standards (Neuhaus 2005). As a result institutions are permanently modified following FDI and Hardy and Smith argue that the general effect on domestic firms is negative as a consequence.

### 2.3.10 Negative Effects

Several further studies point to the negative effects of foreign direct investment as the interests of foreign investors and host countries diverge. Padayachee (1995), analyzing the flow of foreign capital to South Africa, counters the general view of
foreign capital as “panacea” for the economic problems of developing countries. Padayachee argues that the high participation of foreign capital can generate overdependence on multinational corporations. This generates significant risks as exemplified by the bankruptcy of Daewoo Motors. Daewoo’s collapse not only affected its assembly plants in Romania, Poland and Ukraine but also local suppliers and local economies dependent on the multinational company (Pavlinek 2002a). On the other hand, when foreign-owned companies fail to create economic linkages with domestic firms a “dual economy” is liable to develop (Pavlinek 2004: 53; also in Hamar 1999; Mejstrik 1999; Benacek 2000; Hunya 2000; Kapoor 2000; Misun and Tomsik 2001).

In some cases studies suggest that the benefits attributed to FDI have simply failed to materialize. For instance, while FDI is expected to create jobs, foreign participation in the restructuring of privatized state-owned companies has often resulted in considerable job losses (Jansik 2004). Labor shedding also results as privatized companies cut domestic supplier linkages (Hunya and Geischecker 2005). Others suggest that market competition impacts disproportionately on local producers who are forced to lay off workers to stay competitive or close altogether, resulting in an overall reduction of regional employment (Jones and Wren 2006). Moreover, foreign companies can afford to offer higher wages thus attracting away the best employees from local companies (Jones and Wren 2006; Sinani and Meyer 2002). This can have a devastating effect in areas with a scarcity of (qualified) labor.
The practice of offering incentives to foreign companies can also have negative effects on the economy and especially on competition. In Hungary for example, foreign-owned companies produce 86 percent of pre-tax profits but pay only 59 percent of corporate taxes (Hunya 2000). Domestic companies are disadvantaged in the competition with foreign affiliates given this unequal access to incentives (Jansik 2004; Pavlinek 2004). According to Barta and Kovacs (1997), the goal of many market-seeking foreign companies in Hungary was to eliminate their (Hungarian) competitors in order to achieve a monopoly position. Crowding out domestic investment is therefore, another potential negative effect of foreign direct investment (Neuhaus 2005; Agosin and Mayer 2000; Toendel 2001; Damjan et al 2001).

Multinational corporations are well known for being “footloose” and accordingly they have higher closure rates (Jones and Wren 2006). Many foreign corporations started operations in Central and Eastern attracted by the region’s low labor costs. As wages have begun to soar and productivity growth has slowed down, many of these same companies are relocating elsewhere. In 2002 alone two major foreign-owned electronics plants in Hungary relocated to China (Spiro 2004). Furthermore, many foreign companies fail to become embedded in their local economies even after several years of operations. In Hungary again many domestic companies have had difficulty developing a subcontractor relationship with foreign investors (Barta and Kovacs 1997).

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33 Even more damaging is the situation in which state-owned monopoly companies are privatized, thus creating private monopolies, as in the privatization of the Romanian telecommunication company (Romtelecom) to the Greek company OTE (Bonciu 2003).
While FDI usually entails important inflows of capital into the host country, this is not always the case. Foreign companies can borrow at least part of the capital from host-country banks (thus competing for loans with domestic companies) or reinvest profits made by their affiliates (Dicken 2003; UNCTAD 1995). Moreover, repatriated profits can cause a negative balance of payments for the host country (Dicken 2003). The host-country budget is also affected by the fact that foreign corporations often engage in transfer pricing (Dicken 2003). And finally, inward FDI may contribute to the appreciation of the national currency affecting general export competitiveness (Uminski 2001).

A significant number of studies have pointed out that foreign direct investments can contribute substantially to uneven development (Pavlinek 2004; 2002a; Walkenhorst 2001; Michalak 2001, Smith 1996, 1997; Smith and Ferencikova 1998; Pavlinek and Smith 1998; Turnock 2001a; 2001b; 2001c; Chen et al 1995; Rautio and Tykkylainen 2001; Swain 1998). Most foreign investments are attracted to the more developed regions and larger cities, especially capital cities, while underdeveloped and rural areas are left with little foreign investments of note thus increasing regional inequalities (Turnock 2001c; Jansik 2004).

In summary, Bonciu (2003) distinguishes two sets of impacts of FDI on the economies of Central and Eastern Europe based on the time from the initial investment. In the early stage, signs of economic growth may not be evident while national budget deficits may actually increase. This stage is also characterized by accelerated structural changes and an increase in unemployment as most FDI is privatization related. In the mature stage the rate of economic growth accelerates.
and trade is balanced although the balance of payments may be negatively affected as greater profits are repatriated (Bonciu 2003).

2.4 The Concept of Embeddedness

One concept that has proven particularly useful to economic geographers in investigating the impact of FDI on the local economy is that of embeddedness. From this perspective, economic action is seen as integrated into a broader social, cultural, institutional and political framework. The concept can be traced back to Polanyi (1944, 1957) and Granovetter (1985) and found its way into geography in the early 1990s (cf. Hess 2004). Economic geographers have used the term mainly in the context of economic theories of transaction costs and agglomeration economies, including industrial districts (Grabher 1993b; Hsu 2004; Storper 1999; and Hayter 2004).

TNCs are formed and grow locally before expanding internationally. They are therefore “expected to bear at least traces of the economic, social and cultural characteristics of their home territory” (Dicken et al 1994: 34; Dicken 2003; 1998; Doremus et al 1998). TNCs thus reflect the social-cultural territorial milieu in which they develop (ibid; Christopherson 1999; Harzing and Sorge 2003).

On the other hand, over time TNCs are expected to become embedded in the host countries or regions in which they operate (Dicken et al 1994; Clark and

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34 Polanyi argued that social relations are embedded in the economic system. In a seminal study, three decades later, Granovetter (1985) showed the opposite: that economic behavior is actually embedded in social structure. However, Granovetter ignored the influence of cultural factors on economic behavior (cf. Barber 1995), an issue later addressed by DiMaggio (1990; 1994) and Spillman (1999).

When TNCs participate extensively in local economic and social networks, we can characterize them as deeply embedded (Dicken et al 1994). These situations are generally seen as having a positive impact on the local economy, although Grabher (1993a) warns that too much embeddedness can result in regional ‘lock-in’. With production processes enmeshed in the regional culture, isolation from global innovations can lead in time to economic regress, as exemplified by the Ruhr Valley industrial agglomeration (Grabher 1993b).

However, embeddedness is generally considered a positive and therefore, desired outcome. Pavlinek and Smith (1998) analyzed the embeddedness of inward investment in Czech Republic and Slovakia. They found that embeddedness is more apparent when investment occurs in places with industrial strength and traditions, with an already existing local supply network (“path embeddedness”). Where MNE’s ties to the local economy and community are weak or where, following an acquisition of a domestic company by a MNE former linkages and networks are replaced by internationalized systems of supply, we have disembedded plants commonly referred to as “cathedrals in the desert” (Brown 2000; Hardy and Smith 2004; Grabher 1994).
Hess (2004) used the metaphor of the rhizome to emphasize the spatial-temporal dimensions of embeddedness. Hess (2004) distinguishes between three forms of embeddedness. Societal embeddedness considers the social (which includes the cultural and political context) background of the actor, which shapes its action within the local society and beyond. Network embeddedness captures the network of actors a person or organization is involved in regardless of the country of origin. The third form, territorial embeddedness looks at the “extent to which an actor is ‘anchored’ in particular territories or places” (Hess 2004: 177). Economic activity that is embedded reflects local social, cultural, institutional or political characteristics and, at the same time is inscribed into a national frame and influenced by international events and tendencies (Halinen and Tornroos 1998). Hess argues that the three dimensions are knitted together to form the space-time context of socio-economic activity (Hess 2004).

The relationship with (local) suppliers, customers, distributors and competitors is generally seen to be most important indicator of local embeddedness (Meyer 1998). However, we should bear in mind that local embeddedness “reflects both the choices of the TNC and the existence of appropriate firms with which they can interact” (Meyer 1998: 39). Also linkages among firms are governed by both market relationships (arms length ties based on

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35 Hayter (2004) argued that embeddedness is not necessarily territorialized, and can take a continental or global dimension, as Kris Olds and Henry Yeung (Yeung and Olds 2000; and Olds and Yeung 1999 among others) have shown in their studies of Chinese businesses in Southeast Asia and Canada, or even a completely de-territorialized form. The alternative would be to look at embeddedness from a multiscalar perspective (Boyer and Hollingsworth 1997). This implies that institutions at all levels, from supranational organizations to those acting at the local scale act simultaneously and interact in unprecedented configurations that no single institution has the authority to monitor or regulate (Boyer and Hollingsworth 1997: 470).

36 This is what Halinen and Tornroos (1998) call market embeddedness.
contracts) and embedded ties (close and special relationships based on trust, fine-grained information transfer and joint problem-solving arrangements) (Uzzi 1997). These types of relationships can only develop in time; therefore it is important that the interaction between the economic and the social, cultural and political systems be seen from a temporal or “path dependency” perspective (Halinen and Tornroos 1998).

2.5 Concluding Remarks

In this chapter I attempted to review the geographical and non-geographical literature on FDI with a special focus on Central and Eastern Europe. The most important theories were presented in a somewhat historical order culminating with Dunning’s eclectic theory which I chose to be the framework of this study. Of the three types of advantages identified by Dunning to determine in conjunction the flows of FDI, geographers have traditionally focused on the locational advantages. In the second part of this chapter I reviewed the most important locational (geographical) determinants of FDI based on an expansive literature review. Then I discussed the possible impact FDI could have on national and local economies looking at both positive and negative effects. In the end I focused on one of the most desirable effects of FDI discussing the concept of embeddedness.

This chapter has provided the necessary theoretical background in order to understand the framework for my research design and methods. It also helps the reader to see my study in the context of other studies in the region. Foreign direct investment in Romania after 1990 did not happen in a void but rather in a certain
historical and institutional context which will be reviewed in the next chapter. It is important to know and understand this particular historical context in order to fully comprehend the geographical dynamics of FDI in Romania after 1990 and the investment patterns it has generated.
Before analyzing the nature and patterns of FDI in Romania a general understanding of the country’s political and economic transformation would benefit the reader. This historical review will help to situate foreign investor’s choices in Romania. Correlation between the pace of political reforms, economic restructuring and the size of FDI inflows has been noted by a number of scholars (Pickles and Smith 2005; Bradshaw 2005; Hunya 2002b; and Pavlinek 2005). Economic restructuring is heavily dependent on the capital, technology, knowledge and access to the world economy facilitated by foreign investors while at the same time restructuring is a precondition for attracting further foreign investments.

The analysis follows three distinctive historical periods: early capitalism (before 1945), communism (1945 - 1989) and the transition from communism to capitalism and democracy (1990 onwards). Each of these sections provides an overview of the political environment and economic systems that characterized the different historical periods. I also discuss the important role foreign investment played in the early industrialization and economic modernization of Romania and explain the lack of foreign investments in the communist period. The last part of this chapter analyzes the transition period with a special emphasis on the process of privatization. Romania has one of the largest number of foreign investments in the region but most of these are small and the bulk of foreign capital, especially in the
1990s came from the privatization of state-owned companies to foreign investors or from later acquisitions of privatized companies.

### 3.1 Economic Development and the Role of FDI in the Early Industrialization of the Romanian Economy

Romania was founded in 1859 with the unification of two older principalities, Moldova and Wallachia. Both had been under Ottoman suzerainty for centuries and as a consequence remained economically backward compared to the modern states in Western and Central Europe (Turnock 2006). Subsistence agriculture was the dominant economic activity while industry was virtually nonexistent apart from artisan manufacturers (Turnock 1989b). Moreover since the newly created state did not reach full independence until 1878 it also lacked the capacity to borrow money from Western banks in order to finance its economic development (Turnock 1970). Nevertheless a few strategic industries were established in the second half of the nineteenth century including the petroleum industry around the city of Ploiesti (starting in 1857) and the shipyards in Turnu Severin (Turnock 1970). After independence, in 1878, the speed of industrialization increased. Romania managed to create a small domestic industrial sector specialized (besides oil extraction and refining\(^{37}\)) in food processing, leather and textile and lumber industries using Carpathian streams to transport logs (Turnock 1970).

Foreign capital played an important role in the incipient industrialization of Romania. In 1864 British capitalists were the first to invest into the Romanian oil

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\(^{37}\) By 1878 there were 20 refineries in the country (Simanschi 2006).
industry starting the Wallachian Petroleum Co. Ltd. (Busa 2003). As petroleum gained importance for the developing Western economies, foreign investment in Romania increased. The number of foreign-owned companies exploded after 1895 when new mining legislation gave foreign corporations easier access to mineral resources (Busa 2003; Andronic 1999; Turnock 1970). By 1914 there were 92 foreign-owned companies from nine countries in the Romanian oil sector (Busa 2003: 4). Together they accounted for 92% of total investment in the industry (Kastris 1921; Arcadian 1936; Xenopol 1916; and Constantinescu 1937; all cited in Busa 2003; also Turnock 1986). Other economic sectors with important foreign participation included the lumber industry, metallurgy, chemicals, utility sectors (natural gas, electricity and water distribution) as well as food processing and especially the sugar industry (see Table 3.1) (Busa 2003).

38 Germany, UK, Netherlands, France, USA, Belgium, Austria-Hungary, Italy and Sweden.
39 In addition the production of three foreign-owned refineries considerably exceeded the combined production of seventy or so domestically-owned refineries (Turnock 1986: 27)
### Table 3.1: Foreign Investment in Different Economic Sectors in 1913 (in Buna 2003; citing Axenciuc 1977 and Emilian 1918).

<table>
<thead>
<tr>
<th>Economic Sector</th>
<th>Foreign Capital as Percentage of Total Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Natural Gas, Electricity, Water</td>
<td>95.5</td>
</tr>
<tr>
<td>Oil Industry</td>
<td>94.0</td>
</tr>
<tr>
<td>Sugar Industry</td>
<td>94.0</td>
</tr>
<tr>
<td>Metallurgy</td>
<td>74.0</td>
</tr>
<tr>
<td>Chemical Industry</td>
<td>72.0</td>
</tr>
<tr>
<td>Lumber Industry</td>
<td>69.6</td>
</tr>
<tr>
<td>Paper and Cellulose</td>
<td>46.0</td>
</tr>
<tr>
<td>Food Processing</td>
<td>31.0</td>
</tr>
<tr>
<td>Transport</td>
<td>27.0</td>
</tr>
<tr>
<td>Building Materials</td>
<td>27.0</td>
</tr>
<tr>
<td>Textile</td>
<td>21.9</td>
</tr>
<tr>
<td>Total Economy</td>
<td>81.7</td>
</tr>
</tbody>
</table>

The banking sector was also attractive for foreign investors (Andronic 1999). In 1911, the four foreign banks in Romania⁴⁰ had assets equaling the assets of the largest nine domestic banks (Lampe 1975: 77 citing Sitescu 1915).

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⁴⁰ The four foreign banks were: The Bank of Romania Ltd. founded in 1865 with British capital, Banca Generala Romana founded in 1895 with German capital, Banca de Credit Roman founded in 1906 with Austrian capital and Banca Comerciala Romana founded in 1906 with capital from several European banks (Sitescu 1915 cited in Lampe 1975: 77).
The protectionist policies adopted by the Romanian government in 1886 and reinforced in 1906 also encouraged foreign companies to invest directly instead of exporting (Simanschi 2006). Although figures vary between sources, by 1914 foreign investment represented between 69 and 96 percent\(^{41}\) of total investment (Busa 2003 citing Bratianu 1927; Constantinescu 1937, Xenopol 1916, Emilian 1918, Savin 1962, Axenciuc 1977, and Cioriceanu 1918). The uncertainty in the figures results from the lack of official statistics; with authors using different methodologies to calculate the incidence of foreign capital\(^ {42}\) (Busa 2003). In terms of the countries of origin, Germany was the significant source followed by the Netherlands, United Kingdom and Austria-Hungary (see table 3.2).

\(^{41}\) High levels of FDI before 1914 characterized all non-industrial economies. Svedberg (1978; cited in Winder 2006: 791) has argued that in the pre-WWI non-industrial economies FDI represented between 44 and 60 percent of all private investment.

\(^{42}\) Also the figures are based on a wider definition of FDI (Winder 2006). It included all investments in Romania with shareholders as foreign nationals. The Romanian statistics of the time do not distinguish between foreign direct investment and portfolio investment. The distinction between foreign direct investment and portfolio investments was not made until the 1960s in the U.S. and later in other countries (Winder 2006). FDI in that period was characterized by what Dicken (2003) called “shallow integration” although Winder (2006) argued that the extent of transnational webs of the 19\(^{th}\) Century may have been underestimated.
<table>
<thead>
<tr>
<th>Country of Origin</th>
<th>Percentage of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>23.5</td>
</tr>
<tr>
<td>Netherlands</td>
<td>19.5</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>18.9</td>
</tr>
<tr>
<td>Austria-Hungary</td>
<td>12.8</td>
</tr>
<tr>
<td>Belgium</td>
<td>11.3</td>
</tr>
<tr>
<td>USA</td>
<td>4.9</td>
</tr>
<tr>
<td>Italy</td>
<td>1.4</td>
</tr>
</tbody>
</table>

Table 3.2: Foreign Investment countries of origin in 1914 (only for large enterprises)
Source: Busa 2003 (based on data from Alimanisteanu 1915; Emilian 1919; Popovici 1935; Constantinescu and Axenciuc 1962).

In 1910, 168 or one-third of the almost 500 Romanian industrial enterprises were joint-stock companies and more than 80 percent of the capital in those companies was of foreign origin (Lampe 1975: 78 citing Constantinescu 1959 and Anuarul Statistic al Romaniei 1919). Often those who assembled capital from different sources together were immigrant entrepreneurs with family and acquaintances in their home countries providing access to capital and technology (Turnock 1978). In many cases managers and skilled workers were also immigrants. This led Lampe (1975: 79) to conclude that in the pre-1914 Romania technical knowledge was held by individuals rather than foreign companies.

After World War I, Romania gained substantial territory. Transylvania and Bukovina, formerly part of Austria-Hungary, Bessarabia, formerly part of the

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43 In response the protectionist law of 1906 ruled that Romanians should comprise two-thirds of the workforce of a foreign firm within five years (Simanschi 2006).
Russian Empire and South Dobrudja\textsuperscript{44} formerly part of Bulgaria were all attached to Romania more than doubling its area and population\textsuperscript{45}. This also had important economic consequences. Transylvania especially was more industrialized and developed than the rest of Romania (Turnock 1986). Although the region was situated at the periphery of the Austria- Hungary Empire, and its main role was to supply industries in Vienna and Budapest, it was more developed than the outer Carpathian principalities that had been under the Ottoman Empire (Turnock 1970; Mihajlovic 1972: 5). With notable reserves of coal, iron and non-ferrous ores, Transylvania had developed a thriving metallurgical industry with several centers in Southeast Transylvania, and Banat as well as scattered centers in central and Northern Transylvania (Turnock 1986). Heavy engineering industries were also found along the Western strip from Resita to Satu Mare (Turnock 1970).

After World War I, most of the German and Austro-Hungarian companies were replaced by British, French or other Western companies (Andronic 1999) while others were taken over by Romanian industrialists. This was encouraged by the ruling Liberal Party’s policy of “indigenization” of foreign companies\textsuperscript{46}. Their famous slogan “prin noi insine” (“through ourselves alone”) was launched even before the war (Lampe 1975: 83; Turnock 1989b). Because of the constant threat of nationalization, the real owners of enterprises were often “camouflaged” behind “puppet” Romanian owners (Bogdan and Platon 1981). This would make official

\textsuperscript{44} This region was incorporated by Romania in 1913 following the Second Balkan War ending with the defeat of Bulgaria.

\textsuperscript{45} The territory expanded from 137,000 sq. km to 295,049 sq. km and population increased from 8 million to over 18 million in 1918 (Simanschi 2006)

\textsuperscript{46} The 1924 Law limited foreign participation in any company to no more than 40 percent. All subsoil resources (including oil) were made property of the state (Turnock 1986).
statistics on foreign investments a lot less precise. But even so, instead of diminishing, the number of companies with foreign owners more than doubled between 1921 and 1938 (Bogdan and Platon 1981; table 3.3) and the volume of FDI inflows increased continuously despite the economic recession of 1929-1933 (Bogdan and Platon 1981; table 3.4). According to Georgescu (1995), in the 1930s foreign capital’s participation was 21% for the economy as a whole or 40.5% for large enterprises.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of companies with foreign owners</th>
</tr>
</thead>
<tbody>
<tr>
<td>1921</td>
<td>1439</td>
</tr>
<tr>
<td>1927</td>
<td>2745</td>
</tr>
<tr>
<td>1934</td>
<td>2884</td>
</tr>
<tr>
<td>1938</td>
<td>3486</td>
</tr>
</tbody>
</table>

Table 3.3: The number of companies with foreign owners between 1921 and 1938
Source: Bogdan and Platon (1981: 16)

<table>
<thead>
<tr>
<th>Economic Sector</th>
<th>Foreign capital as percent of total capital</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1921</td>
</tr>
<tr>
<td>Total</td>
<td>64.1</td>
</tr>
<tr>
<td>Industry</td>
<td>78.8</td>
</tr>
<tr>
<td>Banking</td>
<td>39.1</td>
</tr>
<tr>
<td>Trade</td>
<td>13.8</td>
</tr>
<tr>
<td>Insurance</td>
<td>88.2</td>
</tr>
<tr>
<td>Transportation and communication</td>
<td>50.5</td>
</tr>
<tr>
<td>Other sectors</td>
<td>38.2</td>
</tr>
</tbody>
</table>

Table 3.4: Changes in the percentage of foreign capital in different economic sectors between 1921 and 1938.
Source: Bogdan and Platon (1981: 39)
Foreign investment clearly had an important impact on the industrialization and modernization of the Romanian economy\textsuperscript{47}. However Bogdan and Platon (1981) claim that in spite of its pervasiveness, there were limits to the impacts of foreign investment. Firstly, very little of the capital invested was directly from foreign locations with most representing reinvested profits. Moreover, foreign investment was often in outdated technology, retired from Western factories. Secondly, in the few situations in which foreign-owned companies used current knowledge and technology, there were limited spillovers to domestic companies. Moreover, foreign investment tended to crowd out domestic investment (Bogdan and Platon 1981). Thirdly, most of these investments were market-seeking rather than enabling the export of value-added products. Numerous foreign companies in the trade sector were simply importing goods to sell on the Romanian domestic market. Simanschi (2006) reported that at the turn of the century imports were 4.4 times higher than exports. And fourthly, Romanians were uneasy with the fact that foreigners controlled the most important mineral resources. All these factors, Bogdan and Platon (1981: 45) argued made Romania directly and indirectly dependent on the more developed Western countries, reducing its political autonomy\textsuperscript{48}.

\textsuperscript{47} The fastest economic growth in this historical period was noted exactly in those sectors that were dominated by foreign capital (Turnock 1986: 26)

\textsuperscript{48} The previously noted 1924 Law was a reaction to the very high levels of foreign investment (especially in the oil industry) which was perceived as a threat to the development of a coherent and independent economic strategy (Turnock 1986).
3.2 FDI during Communism

After the war, with Soviet troops still stationed on Romanian territory, the Communist party won the elections. After forcing the King to abdicate in 1947 and eliminating all other political parties, the Party embarked on the road to communism following the Soviet model. The market-based economy was abandoned in favor of a centralized command economy in which all decisions and actions were planned by the central state and transmitted through the territory (Turnock 2006). This also meant the end of private property as all enterprises were nationalized and peasants were forced to give up their land and livestock and join “co-operatives” (Turnock 1997).

In the Soviet-style reconstruction of the economy emphasis was put on industry and especially heavy industry (Turnock 1989). All countries in Eastern Europe were developed along these lines regardless of their resources (Turnock 1989; 1997; 2003; Tsantis and Pepper 1979). There are a number of reasons that explain this development. First, socialist countries were obsessed with gaining economic independence from the West (Turnock 2006). Heavy industry provides the basis for the engineering sector which in turn produces the machines and tools used in consumer industries. Second, during the Cold War many socialist states in Eastern Europe specialized in manufacturing arms and military equipment. For the military industry it was of paramount importance to have a secure supply base and in case of war civilian engineering could be transformed to produce tanks or other military equipment. Heavy industry was thus seen as a strategic industry for both civilian and military purposes. A third reason for communist preference for heavy
industry was that these kinds of projects were usually very large (see table 3.5). In 1975 average employment in Romanian industrial enterprises was 1554 per firm, perhaps the highest in the world (Tsantis and Pepper 1979: 198). For comparison see the table below:

<table>
<thead>
<tr>
<th>Socialist Countries</th>
<th>Developed Countries</th>
<th>Developing Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Romania 1480</td>
<td>FRG 149</td>
<td>Colombia 71</td>
</tr>
<tr>
<td>Hungary 1070</td>
<td>Austria 96</td>
<td>Brazil (1972) 54</td>
</tr>
<tr>
<td>USSR 712</td>
<td>UK (1972) 87</td>
<td>Korea 49</td>
</tr>
<tr>
<td>Yugoslavia 531</td>
<td>Sweden 68</td>
<td>Greece 41</td>
</tr>
<tr>
<td>Bulgaria 520</td>
<td>Canada 58</td>
<td>Israel 35</td>
</tr>
<tr>
<td>GDR 297</td>
<td>Belgium 35</td>
<td></td>
</tr>
<tr>
<td>Poland 114</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 3.5: Average employment in industrial enterprises in selected countries in 1973 (from Tsantis and Pepper 1979: 200)

One large enterprise was much easier to control and supervise than several smaller enterprises and these large firms were seen to represent a modern and efficient counterpart to those in the West (Tsantis and Pepper 1979; Turnock 1997). This explains the rapid growth of the steel industry and non-ferrous metallurgy in Romania after 1947 as well as the growth of the mining industry as a supplier to these industries (Turnock 1997). Older plants in Transylvania and Banat were modernized and new plants were built in other parts of the country using imported coal and iron ore (Turnock 1997; 1970). One such plant is the steel mill and integrated works in Galati, on the lower Danube, which started producing in 1966 based on raw materials imported from the Soviet Union (Turnock 1986).

Along with other countries in the region, Romania developed a very energy-intensive industry based on cheap electricity and natural gas imported from the Soviet Union (Turnock 1997). Given this generous supply of energy at prices well
below the world market, Romanians were less preoccupied with becoming more energy efficient\footnote{This is another important characteristic of socialist economies. The principal goal was to meet production targets (established in the five-year plans) regardless of the inefficiencies or waste involved in doing so (Turnock 1978).}. Over time this created dependency on Soviet energy. The dissolution of the Soviet Union and the subsequent re-orientation of the newly independent states to a market economy provided a major shock to the Romanian economy. The state had to subsidize energy prices heavily in order to keep these enterprises going (Turnock 1997). Energy-inefficient enterprises have also proved very difficult to restructure or privatize.

Following the socialist model, Romania operated a full-employment economy with an unemployment rate of virtually zero (Turnock 1997). In practice this meant that most enterprises were chronically overstaffed, which in turn contributed to the deterioration of work discipline. Overstaffed enterprises and inefficient work practices represented two of the most significant obstacles in the restructuring and privatization of the Romanian economy.

The heavy industrialization model was pursued throughout Eastern Europe. But in the case of Romania it went hand in hand with attempts to diversify the economy (Tsantis and Pepper 1979). The Council for Mutual Economic Assistance (COMECON) was created as a reaction to the Western Common Market and the Marshall Plan with the goal of establishing a division of labor within the socialist block that would create economies of scale (Turnock 1997). This arrangement favored the Soviet Union and the countries in Central Europe that were already
more industrialized, namely East Germany, Czechoslovakia, Hungary and Poland. These countries were to continue developing industry to supply the entire Eastern bloc with industrial products. The Balkan states, in contrast, were to remain mainly agricultural and develop only marginal industries. Romanian officials resisted such a plan and sought to reduce dependency on the Soviet Union and the other countries in the Eastern block by expanding trade with the West and diversifying the domestic economy (Table 3.6) (Turnock 2006; 1997; 1986; 1970; Tsantis and Pepper 1979).

<table>
<thead>
<tr>
<th>Year</th>
<th>Soviet Union</th>
<th>Rest of Comecon (including Cuba in 1975)</th>
<th>Other Communist Countries (including Cuba in 1960 and 1970)</th>
<th>Industrially Developed Non-Communist States</th>
<th>Non-Communist Developing Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>1960</td>
<td>40.1</td>
<td>26.5</td>
<td>6.4</td>
<td>21.6</td>
<td>5.4</td>
</tr>
<tr>
<td>1970</td>
<td>27.0</td>
<td>21.9</td>
<td>7.0</td>
<td>34.8</td>
<td>9.3</td>
</tr>
<tr>
<td>1975</td>
<td>18.6</td>
<td>19.4</td>
<td>6.8</td>
<td>37.3</td>
<td>17.9</td>
</tr>
</tbody>
</table>

Table 3.6: Romania’s trade between 1960 and 1975 (in percentages)
Source: Turnock (1978: 126)

A further characteristic of socialist industrialization in Romania was the presence of a clear “ideological” component in industrial location decision-making (Turnock 1997). As Turnock indicates, the fact that communist officials were not

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50. The division of labor was rather more detailed than this. For instance, within the COMECON, Russia, Czechoslovakia, Poland and the German Democratic Republic were to develop an automobile industry. Hungary was prevented from manufacturing automobiles, specializing instead in auto parts and buses.  
51. Romania was accorded Most-Favored Nation status by the U.S. in 1975, a status which was then renewed annually (Turnock 2006).
only aware of but sought to apply business location theories is beyond dispute (Turnock 1997). However, the Communist officials were also committed to the equitable distribution of resources and wealth (Turnock 1978; Herbst and Letea 1976). So while they favored concentration in large industrial complexes they also promoted the decentralization of industry and a more geographically even form of economic development based on the industrialization of the less developed regions of the country\(^{52}\) (Turnock 1997; Vidican 2002).

At the end of the 1940s the bulk of industrial activity was concentrated in the Bucharest-Ploiesti area in the South as well as in Southern Transylvania, Banat and a few scattered centers in Northern Transylvania such as Cluj, Baia Mare, Satu Mare and Oradea (Turnock 1986). The rest of the country remained largely agricultural. While the old industrial core was not entirely neglected during socialist industrialization, many enterprises were built in other parts of the country (Turnock 1997). Often industrial plants were built in seemingly arbitrary locations, such as in predominantly rural areas, without consideration for existing resources or economic efficiency (Dobrescu et al 2001). In some cases areas became completely dependent on a single large enterprise\(^{53}\) (Vidican 2002). A further aim was industrial diversification in all counties such that each could produce a range of goods from food to clothing to heavy industry (Dobrescu et al 2001: 9). After 1990 the regions most affected by change were exactly these regions that were forcibly industrialized (Dobrescu et al 2001; Turnock 1997). In the Northeast, for instance, between 1990

\(^{52}\) Turnock (1978: 41) argued that “a high degree of backwardness in a country is […] associated with a large measure of artificiality in its industrial development.”

\(^{53}\) Most of these enterprises were in the metals, engineering, chemical and textile sectors (Turnock 1978: 193).
and 1999 industrial production declined by more than 50 percent (Dobrescu et al 2001).

As noted above, the numerous foreign-owned companies present before the war were nationalized once the region came under the Soviet influence\(^5^4\). The fifties and the sixties were not encouraging for foreign investment (Simai 1998). In 1971 a legislative framework allowed for international cooperation in economic and technical-scientific fields (Negritoiu 1996). Romania was the first communist country to allow joint ventures\(^5^5,5^6\) (Bonciu 2003). Prior to 1990 participation of foreign capital in joint ventures with Romanian enterprises was restricted to a few industrial sectors where acquisition of new technology was deemed critical and could not be obtained through other means. In all cases foreign participation could also not exceed 49 percent of a joint venture (Negritoiu 1996).

The first major investor was the French company, Renault, in the Romanian automobile industry. This was motivated less by economic reasons as “by the French government’s efforts to strengthen the political regime’s international position” (Simai 1998: 350). A number of other joint ventures were established between 1972 and 1975 in areas including computer manufacturing, shipbuilding and chemicals but their impact on the economy, especially in terms of technology transfer was limited (Negritoiu 1996). Other western companies, like Rank Xerox,

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\(^{5^4}\) Simai (1998) claims that a few, isolated examples of small joint ventures remained even after nationalization.

\(^{5^5}\) Other countries that amended legislation to allow joint ventures were Hungary and Poland in the 1970s and Czechoslovakia in 1985. These countries were pressured by their huge debts to the West that effectively prohibited them from raising any new loans. By allowing foreign companies to invest, communist governments saw joint ventures as a means of bringing new technology, boosting productivity and exports and generating funds to repay government debt (Simai 1998, and Michalak 1993).

\(^{5^6}\) Wholly-owned foreign companies were also allowed with special government approval (Matei 2004).
Siemens and ABB opened offices in Romania in the 1980s. While these investments were not particularly profitable they enabled familiarization with the Romanian market which in turn helped these companies to start joint ventures in 1990\textsuperscript{57} (Andronic 1999: 94).

At the end of the 1980s, the contribution of FDI to the economies of Central and Eastern Europe was insignificant. The whole region had received about US$200 million in investments from western companies (Simai 1998). By 1986-1987, there were approximately 700 joint ventures in Poland (averaging $50,000 per investment), 87 in Hungary (averaging $700,000) and only ten in Romania (albeit averaging $8 million per enterprise) (Simai 1998).

3.3 Transition from State Socialism to Capitalism and Democracy

Transition from centrally-planned economies to market economies has taken different forms in Central and Eastern Europe. This is due to the fact that communism affected European countries in different ways and to different degrees\textsuperscript{58}. Countries engaged on the road to capitalism through different approaches and at different speeds (Grabbe 2006; Dunford 1998; Blejer and Skreb 2001; Linn 2001; Sonje and Vujcic 2001). Even within individual countries, the pace of reforms has varied over time with transition alternating between intense and less intense periods (Dabrowski 2001; Dlouhy 2001).

\textsuperscript{57} Rom Team Xerox, the joint venture with Rank Xerox started even earlier, in 1986. After 1990 this company was split into two separate joint ventures, Arexim and Rom Team Solutions (Andronic 1999: 94).

\textsuperscript{58} For a review of the political, social and economic geography of Central and Eastern Europe prior to 1989 see Turnock (1970, 1978, 1986, 1988, 1989a and b, 2001b) and Tsantis and Pepper (1979)
One question that generated considerable debate in the literature was whether transition should be short, as countries apply a “shock therapy” to effect rapid change or progress through a gradual transformation of the political and economic systems. “Shock therapy” was advocated by Jeffrey Sachs (1989; 1993; 1994; 1997; Sachs and Lipton 1990; Lipton and Sachs 1990; Lipton et al 1990; Berg and Sachs 1992) based on the success of the liberalization program undertaken by West Germany after 1945. Later these reforms became the basis of neoliberal theory. In the case of Eastern Europe, Sachs recommended that governments liberalize all prices, eliminate subsidies, float their currencies and sell state assets immediately. While the strategy may have improved economic productivity and had a positive impact on the economy in the long run, its application took a heavy toll on the population. “Shock therapy” was associated with high unemployment rate, increased criminality and a widening gap between rich and poor (Stiglitz 2002)

Kolodko (2001) and others strongly criticized the notion that a market economy could be achieved through “shock therapy”. He argued that an effective market economy required an appropriate set of institutional structures. Since institution building is a gradual process it is logical that a successful market economy could only be attained in time (see also Daianu 2001). Likewise, Dunford (1998), after analyzing the failed implantation of West German state institutions in East Germany, concluded that the state needs to serve as a regulatory formation in transition. This fundamentally challenges the neo-liberal claim that transition is most successful where state institutions are initially dissolved. Moreover, as Smith and Pickles (1998) have argued, state institutions were not solely responsible for
changes; with the collapse of national development planning and the globalization of capital, many decisions were taken and reform strategies shaped by institutions like the IMF or World Bank. Smith and Pickles (1998: 11) concluded that “a diversity of adjustments and responses to post-communism have emerged in local and regional circumstances, drawing on different local capacities, histories, conditions, and modes of insertion in the national and international economy.” This has in time generated variegated “landscapes of transition”.

Politically, the end of communism meant the end of the Communist Party’s monopoly and the beginning of a more widespread popular participation in political life. In some countries (such as Hungary, Czechoslovakia and Poland) this process took place incrementally, with the first parties organized in the 1988-1989 period, and with multi-party elections held in 1989-1990. In other countries, including Romania, communist parties relinquished power only after mass revolt (Turnock 1997).

Most political commentators, however, admit that none of this would have been possible in the absence of Mikhail Gorbachev’s policies of openness (glasnost) and reform (perestroika) (Wejnert 2002a and b; Turnock 2001a and 2003). Gorbachev believed that reforming the governing communist parties would allow them to remain in power, but he failed to anticipate the pressure for continued reforms (Turnock 1997: 84; also Turnock 2001a). This argument finds support from authors who have shown how the attempt of reformists to promote a communism “with a human face” failed in the euphoria of 1989 (Smith and Pickles 1998).
This was also the case of Romania, where during the first days of the revolution Ion Iliescu, then leader of the newly formed National Salvation Front (later three-term president of Romania), continued to use the language of “comrades” and to advocate communism (with a “human face”) as the right choice for Romania. Previously Iliescu had been part of the nomenklatura\textsuperscript{59}, with a high rank in the Communist Party until the 1980s, before falling into disgrace. His discourse evolved as an adaptation to popular pressure, but many political analysts see him as responsible for postponing and slowing the reform process. Iliescu is one of many nomenklaturists who metamorphosed into democrats in Eastern Europe. In fact, with few exceptions communist elites managed “to transform their power base from the political to the economic realm” (Turnock 1997: 87). Only in the former German Democratic Republic (and to a lesser extent the Czech Republic) were the former elites banned from political life and those who cooperated with the state police apparatus investigated (Turnock 1997). Bastian (1998b: 173) makes reference to “elite continuity” whereby communist parties were transformed into political organizations under socialist and social democratic banners and run by people from the second echelon of the former communist parties.

Besides the democratization of political life, marketization of the economy, the privatization of property, and trade and price liberalization were designed to de-
monopolize state power and separate state and economy (Smith and Pickles 1998). However, as Smith and Pickles (1998: 2) suggest, transition involved not only “the implementation of a set of policies involving economic liberalization and

\textsuperscript{59} The term refers to the elite group in Communist Central and Eastern Europe who held administrative position in all spheres of activity. They were all members of the Communist Party.
marketization together with democratization enabling the creation of a market economy and liberal polity”, but also “economic collapse, an onslaught on labor, … while at the same time enabling some to prosper while others fall into abject poverty” (Smith and Pickles 1998:7).

Williams et al (1998) argued that privatization was the most important of the internal reforms that constitute the economic transition model. Through privatization, large sectors of the economy were transferred from state into private ownership. Privatization then is one of the key ideas in the package of neo-liberal reforms designed to implement a market economy (Pavlinek 2002c; Williams et al 1998).

A number of controversies surround the question of privatization (Pavlinek 2002c). Supporters of gradual transition argued that a slow privatization process was necessary to allow state-owned enterprises (SOEs) to restructure prior to placing them on the market. This idea was dismissed by other economists and policy makers because, in their opinion, it would require decades to create genuine enterprise ownership. They advocated instead fast privatization strategies because private owners “are considered to be the best judges of enterprise long-term needs” (Pavlinek 2002c: 1127). A second issue that generated controversy was which enterprises should be privatized first - profitable or non-profitable - and what proportion of these enterprises should be sold to foreign buyers (Michalak 1993).

Although there were many similarities among the Central and Eastern European countries in terms of the privatization process, each country adopted somewhat different methods and a different pace (see also Aghion and Blanchard
1994). Czech Republic (through voucher privatization) and Russia (where state-owned enterprises were mainly sold to managers and employees) were two countries that engaged in a rapid sale of SOEs. In other countries, such as Poland, the process of privatization has moved more slowly, although here too 75 percent of privatized enterprises were leased to workers and managers (Uminski 2001).

Williams et al (1998) noted that Hungary had its own method of large privatization proceeding on a case-by-case basis. For the largest companies strategic investors were preferred, while medium-sized companies were sold to the highest bidder. Hungary was seen as successful in the early stages of privatization (1990-1994) with foreign direct sales amounting to the equivalent of 10% of GDP in 1994.

In general Williams et al (1998: 135) distinguished three phases of privatization in Central and Eastern Europe:

1. The first phase began immediately after 1989 (earlier still in the case of Poland). This first period lasted two to three years and generally included small businesses such as shops, restaurants and service outlets (this phase is also called commercialization by other authors, for example Uminski 2001; and Todaro and Smith 2003).

2. In the second phase, medium and large state-owned enterprises (SOEs) were privatized via tenders and direct sales. Mass privatizations were also organized to convert SOEs into joint-stock companies and coupons were distributed to allow individuals to buy company shares. Pavlinek (2000) terms this “voucher privatization”.
The third phase was initiated by the major industrial and financial groups, who “accumulated diluted shareholdings from the mass privatization programs in the Czech and Slovak Republics, and subsequently used the leverage effects of majority stakes in investment funds to secure control of larger volume of capital in underlying companies” (Williams et al. 1998: 135 quoting Balaz 1996).

In general privatization in Romania followed the same pattern albeit at a slower pace. In 1990 the Law of State Enterprise Reorganization divided all state-owned companies into two groups (Telegdy 2002). Commercial companies were reorganized under either the limited liability or joint-stock form and were the first to be privatized. The second group of firms, labeled in Romanian Regii Autonome, remained under state authority. This group included so-called strategic companies, in areas such as arms manufacturing, energy production, mining and natural gas, postal and railway transportation, utilities or other companies that enjoyed a monopolistic position\(^60\) (Telegdy 2002; Negrescu 1999). However, the category was loosely defined and ultimately also included companies from a range of additional sectors including construction, trade, publishing, horse breeding, collection and processing of medicinal plants, and the tobacco industry (Telegdy 2002: 3; Negrescu 1999: 6). While companies in this second group were not large in number\(^61\) they were by and large sizable firms, accounting for 47 percent of total capital value of all state-owned companies in the early 1990s (Telegdy 2002; Earle

\(^{60}\) It also included state companies involved in national security, public health and public order (Negrescu 1999).

\(^{61}\) There were 950 companies in this group of which 80 were established as ‘national’ firms (Negrescu 1999: 6).
and Telegdy 2002). Practically this meant that almost half of the capital value tied up in Romanian enterprises was protected from privatization (Telegdy 2002).

Initial privatization included small companies in the trade or service sectors. Very few industrial or larger companies were privatized in the early 1990s and the process moved slowly. In an attempt to accelerate the privatization program the government decided that thirty percent of the nominal shares in all commercial companies should be distributed to eligible Romanian citizens and new legislation in 1991 established three main institutions to handle the process of privatization (Popescu 1999; Marinescu 2003; table 3.7). The National Agency for Privatization (NAP) was to oversee the entire process and to establish the appropriate strategies. The State Ownership Fund (SOF) was charged with administering and selling shares of privatizing SOEs to certificate holders. It was initially allocated 70 percent of the nominal capital of commercial companies, but this was to be incrementally reduced as privatization advanced (Popescu 1999). Thirdly, the Private Ownership Funds (POFs) were designed to administer the 30 percent shares of state-owned companies that were distributed for free under the mass privatization program. Ownership certificates were issued by five Private Ownership Funds to some 16.5 million Romanians. The holders had five years to exchange the certificates for shares in any company privatized during that period. They were also entitled to freely sell and buy certificates.
<table>
<thead>
<tr>
<th>Country</th>
<th>Mass Privatization (percent of total)</th>
<th>Tenders, Auctions, Direct Sales (includes insider privatization) (percent of total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>14.6 %</td>
<td>85.4 %</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>54.0 %</td>
<td>29.4 %</td>
</tr>
<tr>
<td>Hungary</td>
<td>9.5 %</td>
<td>89.4 %</td>
</tr>
<tr>
<td>Poland</td>
<td>8.4 %</td>
<td>90.6 %</td>
</tr>
<tr>
<td>Romania</td>
<td>30.0 %</td>
<td>70.0 %</td>
</tr>
<tr>
<td>Slovakia</td>
<td>18.8 %</td>
<td>33.5 %</td>
</tr>
</tbody>
</table>

Table 3.7: The use of mass privatization in selected countries in Central and Eastern Europe
Source: EPIC 2003

However, progress remained limited and by July 1994 only a little more than 17 percent of the 791 companies included in the initial package had been privatized (Popescu 1999). In order to further accelerate the process a second phase was launched in 1995, targeting another 1,035 industrial companies. This time ownership certificates were replaced by nominal coupons that could be traded for shares in privatizing enterprises in a relatively short time period (Popescu 1999; Turnock 2003). Popescu argues that privatization was somewhat complicated by the tight timing schedule, and also by the proliferation of institutions involved. Besides the three agencies noted above, several ministries as well as local and regional authorities were also involved in the privatization process and their institutional responsibilities were not always clearly specified (Popescu 1999; Marinescu...
nominated by the major political parties, making it vulnerable to political influence (Marinescu 2003; Earle and Telegdy 2002). Since most state-owned companies were chronically overstaffed and highly inefficient their privatization and subsequent restructuring was usually associated with labor shedding and downsizing. Such measures were not popular with voters and parties endorsing them quickly lost popularity.

Romania is not the only country in Central and Eastern Europe that used voucher privatization. This was the favored privatization method in Czech Republic (or Czechoslovakia before 1993), where voucher privatization was implemented over two “waves” between 1992 and 1994 and had a very high participation rate (Myant 2000). Myant argued that voucher privatization allowed for speedy privatization and economic transformation, but subsequent economic performance of privatized enterprises failed to confirm to these expectations. Economic reports indicated that the most successful were those enterprises sold directly to foreign investors while enterprises privatized by the voucher method performed poorly. It is not surprising, therefore, that such programs attracted harsh criticism from the very beginning. M. Zeman, the chair of the Social Democratic

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62 This was in sharp contrast with the situation in Hungary, where the entire process of privatization was managed and coordinated by a single institution headquartered in the capital (Mihalyi 2001).
63 Honkkila (2000) and Martin (2000) contended that large-scale job losses have been associated with privatization in most transition countries while the private enterprises created were not able to absorb entirely the labor released by the restructuring of formerly state-owned enterprises (see also Katsanevas 2000 for the effects of privatization on employment in Bulgaria, Romania and Albania).
64 Other countries in Central and Eastern Europe that employed mass privatization methods were Russia, Slovakia, Poland, and Bulgaria (The Slovak Spectator 1996; Djankov and Pohl 1997; Todaro and Smith 2003). Nellis (1999) showed that countries like Albania or Moldova that favored mass privatizations were not very successful in restructuring their economies. They claim that dispersing ownership among the population inhibits effective governance of the privatized enterprises.
Party (and later Prime Minister) called voucher privatization “the fraud of the century” and Czech Republic “the first state that has succeeded in almost robbing itself” (Prace, 5 April 1993 cited in Myant 2000: 1).

The main problem with this type of privatization was that it created a highly dispersed ownership. In Czech Republic, for instance several million citizens were involved in the scheme, comprising more than 70 percent of the adult population (Weiss and Nikitin 2001). Investment funds were limited in their participation since none of the funds were allowed to own more than twenty percent of the shares in any given enterprise. Therefore, ownership was dispersed among many shareholders who had difficulty asserting any authority. In Romania ownership was even more dispersed than in the Czech Republic because of a special provision of the law that precluded the emergence of any single blockholder (Telegdy 2002). Furthermore, when exchanging coupons for shares, better performing companies and those that were better known received more privatization coupons while others received less. In all cases, regardless of the number of coupons received, only 30 percent of these companies were privatized using this method. Ironically, in companies that received a greater number of coupons, shares were then worth less than in companies that received fewer coupons (Telegdy 2002). This has also contributed to the dispersal of ownership in the most popular companies. Since the state continued to own most shares in all mass privatized companies it maintained control of these companies for several more years.

Under such circumstances, decision-making power rested firmly with the management of each enterprise (Myant 2000). In many cases, managers were
accused of intentionally mismanaging the enterprises so that they could accumulate majority shares at low prices (Myant 2000). In the absence of any corporate governance structures, managers of state-owned enterprises (SOEs) traded freely with their own companies or with companies that they or their allies controlled. This relationship was generally advantageous for the private companies and disadvantageous to the SOEs. When state enterprises were finally selected for privatization they were often so economically weak that the state was happy to sell them for pennies, usually to the firm’s managers. Such practices have been described as “tunneling” in the Czech privatization context (Pavlinek 2002c). In Romania the private companies that lived on the back of SOEs were referred to in the media as “tick firms”.

A further reason for the failure of voucher privatization in restructuring companies is that such offerings attracted very little or no capital to finance restructuring (Pavlinek 2002c). As Pavlinek (2002c) indicates investment privatization funds (Private Ownership Funds in Romania) were often not the best owners, knowing little about the range of businesses in which they owned shares. Although in Romania voucher privatization did not affect as many enterprises and was much slower than in the Czech Republic, the problems were much the same. Consequently restructuring was either slow or nonexistent in the privatized enterprises.

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65 In Romania only about two-thirds of the commercial companies were included for mass privatization and only 30 percent of each of these enterprises was privatized using vouchers or coupons (Telegdy 2002).
An alternative form of privatization employed especially after 1994 was the insider privatization or MEBO (management- employee buy-out) in which the ownership of companies was transferred to managers and employees. In order to consolidate ownership, managers and employees who owned shares in the company had to form an association (PAS in Romanian). Before 1996 this was the preferred privatization method in Romania (Telegdy 2002; table 3.8). The 1991 Privatization Law already offered preferential treatment to insiders in the case of public offerings and auctions (Telegdy 2002: 6). The preferential treatment included credit guaranteed by the State Ownership Fund (SOF) for the purchase of the shares at very low rates of interest. The new owners could then use profits to pay back the loan, especially since profits were exempted from tax during the repayment period (Telegdy 2002). Because profits could not be reinvested (at least until loans were paid off), the infusion of fresh capital necessary for restructuring was minimal.

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<tbody>
<tr>
<td>Number of companies sold by MEBO</td>
<td>265</td>
<td>604</td>
<td>648</td>
<td>1388</td>
<td>2905</td>
</tr>
<tr>
<td>MEBO as percentage of total privatization</td>
<td>98.5</td>
<td>85.9</td>
<td>6.6</td>
<td>1.0</td>
<td>28.8</td>
</tr>
</tbody>
</table>

Table 3.8: Number of insider privatizations in Romania 1993-1996
Source: Negrescu (1999)

66 Before 1996 this was the single most important privatization method (Telegdy 2002: 5). In 1996 insiders owned 61 percent of all privatized enterprises while coupon owners had received on average 18 percent and domestic and foreign outsiders accounted for only 14 and seven percent respectively (Telegdy 2002: 5).

67 In fact when inflation is taken into account the interest rate is highly negative. Usually interest rates for these preferential credit offers ranged between 10 and 25 percent, while annual inflation in 1993-1994 varied between 150 and 250 percent (Telegdy 2002: 7).
Nellis (1999: 9) argued that privatization of this form is little more than a “transfer of productive resources from the state to a fortunate few who-unconstrained by tradition, effective laws, or countervailing powers stripped the assets from the firms, and did not restore growth and create jobs, actions that might have justified such a transfer” (Nellis 1999: 9). Insider privatization has only very rarely been associated with restructuring of the privatized enterprises (Nellis 1999). According to Turnock (1997), after privatizing through this method, while the enterprise might show some signs of initial revival eventually the conflict between employees, interested in protecting jobs and boosting wages and management’s interest in profit and reinvestment, becomes an obstacle to restructuring. Even in cases when only one or a small number of managers and/or employees assume control the possibilities for restructuring are limited as privatization contracts usually include stipulations that prevent new owner(s) from altering the main activity of the firm, selling shares or laying off workers, at least for an initial period of time (Telegdy 2002).

Although not completely abandoned, after 1996 MEBO was less frequently used as a privatization method. Following the 1996 legislative changes no privatization deals were formerly recorded as MEBO. Some enterprises were sold to employees following direct negotiations or auctions but these transactions were not recorded as MEBO as the preferential treatment previously given to new MEBO owners no longer applied (Negrescu 1999). Romania reverted to a case-by-case approach to privatization, often involving the participation of foreign investors (Marinescu 2003). Different sales methods were employed including auctions, direct negotiations and public offerings (Telegdy 2002). In the case of auctions all

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68 Following the 1996 legislative changes no privatization deals were formerly recorded as MEBO. Some enterprises were sold to employees following direct negotiations or auctions but these transactions were not recorded as MEBO as the preferential treatment previously given to new MEBO owners no longer applied (Negrescu 1999).

69 Case-by-case privatization has been applied in Romania since the early 1990s but gained a significant share of privatizations only after 1996 (Telegdy 2002).
participants had to meet a number of formal requirements to participate but the main
criterion in selecting the winning bids was price (Negrescu 1999). In the case of
direct negotiations lower prices were often accepted for the acquisition of state-
owned enterprises in exchange for investment commitments on the part of the new
owner. This proved to be a constant source of troubles as there were no guarantees
that investments committed would actually materialize (Negrescu 1999). The
strategy of selling companies directly on the capital market met with very limited
success (Negrescu 1999). In 1996 and 1997, direct negotiations were used in most
privatization cases, while more recently auctions have become the most popular
mode for selling state assets (table 3.9).

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<thead>
<tr>
<th></th>
<th>Auctions</th>
<th>Direct Negotiations</th>
<th>Sales on Capital Market</th>
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<tbody>
<tr>
<td></td>
<td>Number</td>
<td>% of total</td>
<td>Number</td>
</tr>
<tr>
<td>1996</td>
<td>455</td>
<td>31.3</td>
<td>1006</td>
</tr>
<tr>
<td>1997</td>
<td>231</td>
<td>17.7</td>
<td>1064</td>
</tr>
<tr>
<td>1998</td>
<td>991</td>
<td>78.2</td>
<td>244</td>
</tr>
<tr>
<td>I-VIII 1999</td>
<td>1000</td>
<td>79.6</td>
<td>204</td>
</tr>
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Table 3.9: Privatization using direct sale methods in Romania between 1996 and
August 1999.
Source: Negrescu (1999: 41)

Despite various shifts in policy and practice, privatizations progressed only
slowly in large part because of the high asking price for shares administered by the
State Ownership Fund. While many privatizing enterprises may have fetched such
prices at the beginning of the 1990s, years of poor management and the absence of
significant restructuring had diminished their attraction. The accumulation of debts and the loss of market share had tarnished many of them in the eyes of foreign as well as domestic investors. Moreover frequent changes of the legislation pertaining to privatization represented another obstacle despite the fact that the purpose of these legislative changes was exactly to accelerate privatizations by relaxing some of the earlier constraints and provisions (Negrescu 1999). An additional problem was the emphasis SOF put on labor protection especially during direct negotiations with interested investors. A Government Ordinance released in 1997 made it mandatory for all privatization contracts to contain clauses on the future of the existing workforce (Negrescu 1999). The new owners could not lay off workers collectively unless adequate provisions were made for their fair compensation. Moreover, in cases such measures were negotiated the union had to be informed about them, which proved a constant source of trouble (Negrescu 1999).

By mid-1999, in spite of some evidence of progress, the privatization of large state-owned enterprises continued to move slowly (Ahrend and Oliveira Martins 2003; table 3.10). SOF had privatized only 32 percent of formerly state-

70 Sales were dependent upon the state assuming debt arrears. For example, the privatization of SIDEX, one of the biggest steel makers in Europe producing 50 percent of Romania’s steel, with over 27,000 workers, generated $65 million which fell far short of the $1 billion in arrears also absorbed by the state (Hunya 2002).
71 Between May 1997 and June 1999 there were 15 changes in the legislation of which seven were considered major (Negrescu 1999: 39).
72 According to Negrescu (1999: 37) only 83 large companies had been privatized between 1993 and 1998 with another 183 companies privatized in the first six months of 1999.
owned companies which represented 27.8\textsuperscript{73} percent of the total assets owned by the state in 1989 (Negrescu 1999: 4).

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<tbody>
<tr>
<td>Number of companies at the beginning of the year\textsuperscript{74}</td>
<td>5937</td>
<td>6291</td>
<td>7602</td>
<td>9010</td>
<td>…</td>
<td>5554</td>
<td>4330</td>
</tr>
<tr>
<td>Number of companies privatized during the year</td>
<td>265</td>
<td>604</td>
<td>648</td>
<td>1388</td>
<td>1304</td>
<td>1267</td>
<td>1255</td>
</tr>
<tr>
<td>Percentage privatized during the year</td>
<td>4.5</td>
<td>9.6</td>
<td>8.5</td>
<td>15.4</td>
<td>…</td>
<td>22.8</td>
<td>30.0</td>
</tr>
</tbody>
</table>

Table 3.10: Evolution of SOF’s portfolio (from Negrescu 1999: 5)

The pace of privatization increased significantly after 1996. In that year elections were won by a coalition of parties on the political “right”, expressing a stronger will to privatize. In 1997 the *regii autonome* were incorporated as joint-stock companies and declared privatizable\textsuperscript{75}. The new government was also more open to attracting foreign investment and the number of privatizations involving foreign investors increased from 11 in the three-year period between 1993-1996 to 201 between 1997 and the first half of 1999 (Negrescu 1999: 37). By the middle of 2000, state ownership accounted for no more than 28 percent of total employment. However, the state owned 46.9 of the economy based on the capital value of commercial firms and much more if the strategic companies (“*regii autonome*”) are

\textsuperscript{73} If we consider the 30 percent shares distributed to the population through the mass privatization program the figure increases to 52.4 percent. However this is only for commercial companies; including the *regii autonome* reduces the share to 27.8 percent (Negrescu 1999: 4).

\textsuperscript{74} The variation in the portfolio is due to the frequent break-ups of state-owned companies into smaller units (Negrescu 1999).

\textsuperscript{75} The government also enacted laws to deregulate the public utilities sector (telecoms, railway transportation and electrical energy) (Negrescu 1999)
included (Telegdy 2002: 5). Such figures indicate that the privatization of capital-intensive firms (for instance banks) started after 2002.

The first strategic company was offered for privatization to foreign investors in 1998. The Greek OTE acquired 35 percent of Romtelecom for $675 million and increased its share to 51 percent in 2003 for an additional $243 million. Romania’s prospects for joining the EU and NATO have had a positive impact on FDI as the country was forced to harmonize its legislation with EU equivalents (Grabbe 2006) while also convincing foreign investors that the country is moving forward with political and economic reforms.

3.4 Conclusion

The purpose of this chapter was to provide background information in order to better understand the evolution of inward FDI in Romania after 1990. Until World War II Romania’s economy was dominated by foreign companies. While foreign investments played an important role in the industrialization and modernization of the Romanian economy, especially before 1914, foreign control of certain strategic economic sectors (like mining and oil industry) generated significant popular resentment and was seen as limiting Romania’s economic and political independence. This negative attitude towards foreign investors was clearly manifest in the National Liberal Party’s promotion of an indigenization of the economy.

76 Also, in 2001 the state still controlled 42 percent of the industrial sector (Ahrend and Oliveira Martins 2003).

77 Romania joined NATO in 2004. However, it missed the first wave of accession into the EU in 2004 but was incorporated into the EU along with Bulgaria on January 1, 2007.
During the communist period all foreign and domestic companies were nationalized and the entrance of new foreign investments was seriously restricted. The communist program sought to reject capitalism and investors and entrepreneurs were depicted as unscrupulous businessmen with no concern for workers or for the country’s development. These ideas were unchallenged during the forty years of communist rule and changing these views has been difficult despite the post-1990 transition to capitalism. This was, clearly also a reflection of the painful measures commonly associated with privatization and restructuring.

After the 1989 revolution, Romania preferred a more gradual change to the “shock therapy” implemented elsewhere. Privatization and restructuring moved slowly especially before 1996. On the one hand the country was governed by a center-left party with numerous former communist nomenklatura among its leaders, who were clearly less inclined to adhere to neo-liberal economic philosophy. On the other hand the transition to capitalism was associated with price liberalization, high inflation levels, plant closures and labor shedding. The small private businesses that emerged after 1990 could simply not absorb the redundant labor from the restructured state-owned enterprises and numerous labor conflicts and other social tensions mitigated against “shock therapy”. Consequently governments were hesitant to accelerate reforms.

The center-right party coalition that governed Romania between 1996 and 2000 was more determined to privatize and restructure the economy. The coalition was also more open to foreign investors not least in the process of privatizing state-owned companies. Consequently the number of privatizations and acquisitions by
foreign companies increased in this period although numerous changes in the enabling legislation are seen to have hindered even further growth.

In elections in 2000 the center-right coalition was replaced by the center-left party that had governed Romania before 1996. By then, however, Romania was well on the road to joining the Euro-Atlantic community through NATO and the EU. The prospect of accession has boosted the pace of privatization as Romania has been compelled to align its legislation and economic practices with those of the European Union. Accession has also increased the confidence of foreign investors in the stability of the Romanian economy. Strategic companies, from banking to energy and utility sectors have been sold one by one to foreign investors, especially after 2003. In 2004 Romania joined NATO and on January 1, 2007 it became a full member of the European Union.
Chapter 4: METHODOLOGY

This chapter identifies the main methods employed by this study to investigate the issues and answer the questions raised in the introductory chapter. It explains the sources for data and information utilized in this study and lays out the research design while recognizing the merits and limitations of the chosen research methods.

4.1 Methods Used

This study employs a range of quantitative and qualitative methods. The combination of these methods is not unusual in the geographical literature. Both have merits and limitations and using them together would strengthen the outcomes of the study. For several decades geographers have preferred to use quantitative methods in their research because they considered them more scientific. This is even more true in economic geography where geographers compete with economists, who by nature are positivist in their scientific approach. The main advantage of using a positivist approach is that final results are quantified and could be measured, compared and ranked.

Quantitative methods, however, can hardly capture the diversity of our human society. As Smith (2001: 24-25) put it: “The world is not real in a fixed, stable or predictable way,” and surely it does not appear empirically the same to everyone. Smith sees the world as “an assemblage of competing social constructions, representations and performances” (pages 24-25). The social world is dynamic; it changes continuously, “always being constructed through the intersection of cultural, economic, social and political processes” (Dwyer and Limb
These different views cannot be easily quantified; therefore a different scientific method is needed to capture them. In this case using an in-depth intensive approach would be appropriate. This approach to research is however not without fault itself because, if not keeping information and results in perspective “the researcher can easily ‘miss the forest for the trees’” (Deichmann 1999: 70). Combining the two methods however allows the researcher to increase the veracity of the study while minimizing its limitations.

4.2 Research Design

Research for this study was completed in three phases. The first phase involved mainly archival and library research. This was conducted not only at the beginning but also throughout the length of the study. Preliminary interviews with Romanian authorities at different governmental institutions were also conducted during this phase. The second phase was based on a questionnaire sent to a representative sample of foreign companies. The third phase involved interviews with foreign investors, local authorities, and officials in different governmental or non-governmental institutions and organizations.

4.2.1 Phase One

In this phase, data from different sources, including the Romanian Agency for Foreign Investments (ARIS), the National Trade Register Office, the National Institute of Statistics, the National Bank of Romania (BNS), the Ministry of European Integration, and the Foreign Investors’ Council was compiled and
analyzed. International data sources were also used. Of these sources, data sets from the United Nations Conference on Trade and Development (UNCTAD), the Organization for Economic Cooperation and Development (OECD) and the International Monetary Fund (IMF) were especially useful.

For reasons that I will discuss later in this chapter, I found (sometimes important) discrepancies in the data from different sources. Therefore, for data on global FDI and regional FDI in Central and Eastern Europe I use UNCTAD as my primary source. When comparing with other countries I also use data for Romania published by UNCTAD even though their figures may differ from those published by Romanian institutions. In Romania, the National Bank of Romania and the National Trade Register Office both publish statistics on FDI flows and stock in Romania. Their figures however are different due to their different ways of calculating FDI indicators. For the purpose of this study I decided to use data published by the National Trade Register Office because their data base (or at least what was available to the public) seemed to be more complete.

Then during the summer of 2005 I did extensive archival work in three university libraries in Romania (Bucharest, Cluj and Baia Mare) and at the National Institute of Statistics’ library. Also during the summer of 2005 in Bucharest I met with representatives of the Romanian Agency for Foreign Investments, Ministry of Foreign Affairs, the National Trade Register Office and the National Institute of Statistics in order to better understand the relationship between the government (and its different institutions and agencies) and foreign investors and to better understand
how data regarding foreign investments in Romania is recorded and what sets of data to choose for my research.

**4.2.2 Phase Two**

In order to gather information on the main determinants of FDI and the degree of embeddedness into local and national economies a questionnaire was designed. The questionnaire contained a mix of close-ended and open-ended questions. The close-ended questions have the advantage of recording quantifiable information that could then be rated and ranked. The open-ended questions give respondents the possibility to discuss issues that may have never been anticipated by the researcher.

Due to the very high number of foreign-owned companies in Romania (over 130,000) and limited resources using a representative sample across all economic sectors was not feasible. One method some scholars used to limit the number of investments in study was to reduce the scope of the study to include only the largest investments. Deichmann (1999), for example, limited the scope of his research to large investments of USD 1 million or over. However in Romania the great majority of foreign direct investments are small and very small. As shown in a different chapter almost 80 percent of all FDI in Romania are under USD 10,000 and only less than two percent are over USD 1 million. By eliminating 98 percent of foreign investments the results would certainly be skewed. I preferred instead to limit the scope of the research by considering only two manufacturing sectors. John Pickle and Adrian Smith (2005) have used the same approach when analyzing FDI in the textile and clothing industry in Bulgaria and Slovakia.
4.2.3 Phase Three

This phase involved in-depth interviews with a number of selected companies to better understand the mechanisms that influenced these firms’ decision to invest in Romania and the nature and extent of their embeddedness. The interviews took place during the summer of 2006 with the exception of one phone interview which took place in December 2006. Interviewing was identified as the ideal method “to verify, build on and add depth to the results of the questionnaire survey” (Kitchin and Tate 2000: 41; also in Hoggart et al. 2002).

Both closed-ended and open-ended questions were administered, with the predominance of the latter. Hughes (1999) refers to this type of interviews as semi-structured interviews. The advantage of this method is that the researcher has a set of themes to discuss with the respondent which can be addressed in any order generating more flexibility in terms of how much time can be spent answering each question (Healey and Rawlinson 1993).

Other in-depth interviews were conducted with representatives of local and regional authorities (as also suggested by Healey and Rawlinson 1993). The purpose of these interviews was to capture local authorities’ attitudes towards foreign investors. The qualitative data resulting from the interviews was used to complement the large-scale survey and data analysis. Many other interviews with industry representatives, foreign-owned company CEOs and local authorities have been published in the Romanian as well as international media and were used as secondary sources.
4.3 Sectoral Approach

The two manufacturing sectors selected for this research are the textile, clothing and footwear sector and the automotive sector. These are two of the most internationalized economic sectors yet they have very different characteristics in terms of their relationship to globalization (Dicken 2003). The textile, clothing and footwear industry has very low requirements in terms of capital and know-how. Thanks to this quality, this industry is present even in the least developed countries. Innovations in transportation technologies (like the use of containerized shipping) and communication technologies (the use of computers, internet and bar code readers among others) have cut transportation cost to a fraction and have made it possible for the companies to manufacture anywhere in the world making labor costs the most important variable in production site selection.

On the other hand, automobile factories tend to be very large, use a great number of components and materials and require substantial capital investments and specialized know-how that are available only in a few countries or to a few companies. Therefore this industry may employ different internationalization strategies than the textile, clothing and footwear industry. Given these differences, the two sectors may provide a useful comparative window on FDI flows and impacts on the local economies in Romania. There are sixty-six foreign-owned automotive companies and 3,126 foreign-owned companies in the textile, clothing and footwear sector in Romania.
The questionnaire was sent to a number of 485 companies. All known foreign-owned automotive companies were included in the survey\textsuperscript{78} whereas among all foreign TCF companies the questionnaire was sent to a representative sample of 434 TCF plants. The list of foreign-owned automotive companies was compiled from many different secondary sources (media, websites of several agencies, organizations and associations like the Romanian Agency for Foreign Investments, Automotive Manufacturers and Importers Association and Central Europe Trust Company. The names and addresses for TCF companies were obtained from the National Trade Register Office.

For the automotive companies the response rate was 20 percent or close to 30 percent if we considered only those companies that were operational for a full two years at the time of the survey.

4.4 Limitations of the Study

While the findings from this research show many similarities to results from other studies in Central and Eastern Europe, the reader should keep in mind that certain limitations apply when interpreting the results from this study. These limitations, however do not detract from the merits of this dissertation.

4.4.1 Spatial Limitations

Firstly, the study is limited to Romania. While FDI patterns in other Central and Eastern European countries may be very similar in some aspects no inferences

\textsuperscript{78} The sixty-six factories are owned by fifty-one companies.
should be made about FDI in Central and Eastern Europe based on results from this study. As discussed in another chapter Romania had a somewhat different historical economic trajectory than other countries in the region which explains the differences in the dynamics and patterns of FDI flows.

I have analyzed the dynamics and patterns of FDI at national, regional and county level. However analysis of FDI determinants and impacts was not possible at regional and county level due to the low questionnaire response rate. Due to the same reason it was not possible to identify differences in determinants and embeddedness based on the nationality of the foreign company.

**4.4.2 Temporal Limitations**

Data for most of the indicators reflect the situation as of October 2006. The automotive and TCF companies included in the study are those from the summer of 2006 when the questionnaires were sent. Especially the automotive industry is very dynamic and new foreign companies are investing in Romania almost every month. Some of the factors included in the study may have changed as political and economic conditions have changed after Romania’s accession to the EU. For example, many incentives that were available to foreign investors were discontinued after accession due the EU regulations. Also wages and operating costs are constantly rising in Romania eroding the country’s attractiveness to the category of foreign investors that are wage and resource-driven, while on the other hand offering more opportunities to market-seeking investors. Also with Romania part of
the EU many trade barriers were eliminated possibly making imports cheaper and
easier than direct investments.

**4.4.3 Sectoral Limitations**

The reader should also keep in mind that foreign companies from only two
economic sectors were included in the survey to answer questions on the
determinants and impact of FDI in Romania. This is important because there may be
major differences in the characteristics of FDI in manufacturing and services.
Service foreign companies come to Romania presumably to serve the domestic
market whereas manufacturing companies may be attracted by the domestic market
or by the lower production costs (especially labor). This also constitutes a limitation
of the study.

**4.4.4 Data Limitations**

Another limitation of the study comes from the relatively low response rate. For the
automotive companies the response rate was 20 percent or close to 30 percent if
only those companies that were operational for a full two years at the time of the
survey are considered. In the case of the textile industry I received responses from
24 companies representing less than 6 percent of the number pf surveys mailed and
0.78 percent of the total number of foreign-owned TCF companies in Romania.
Although the results compare very well with results from other studies and are
reinforced by articles about the state of the industry and interviews with industry
representatives published in specialized media, they have to be interpreted with some degree of caution.

The post-2001 data on the regional distribution of FDI in Romania is more reliable although comparable data for the period before 2001 is harder to come by. Data for the pre-2001 period was pieced together from different sources. Whenever data is compiled from different sources there is the question of compatibility. There is no international (or national) standard for recording or measuring foreign direct investment (Bouma 1996). In most cases, not all investments are recorded. The question then becomes: What are the criteria used to select those investments that are recorded? (For instance, are reinvested earnings recorded as foreign investments or not?) For example The National Bank of Romania and the National Trade Register Office use different criteria when recording data on foreign direct investment.

Moreover, whereas in the Czech Republic and Hungary FDI is registered after the payment of the statutory capital, in Romania FDI is registered (at least by some agencies) prior to being set (Meyer 1998). The solution when comparing indicators in different countries was to use data released by an international agency (like UNCTAD) rather than use data from the respective national agencies.

It is also difficult to tell whether reported FDI capital refers only to foreign equity contribution or to total equity or includes equity and loan capital (Meyer 1998: 26). There were numerous cases when the foreign investor’s contribution was made partially or entirely in kind. For example, in some cases, machines or other
equipment were contributed. This makes it very difficult to evaluate the foreign equity contribution.

Another complication is caused by the fact that the origin of the capital does not always match the investor’s country of origin. This is often due to the fact that the investment is realized through a third country for fiscal or other reasons (Bouma 1996). For example, the capital for Mittal Steel’s investment in SIDEX came from the Netherlands and not from UK or India. In other cases the investment is made indirectly through a subsidiary owned by the company. For instance, the Macedonian telecom company was acquired by the Hungarian telecommunications company and was registered as a Hungarian investment (the largest in Macedonia to date). However, Deutsche Telecom is the majority owner of Magyar Telecom (formerly Matav). Thus, we have to be cautious when analyzing the geographic origin of foreign investments in Romania.

No less confusing are data on investment stocks (Bouma 1996). These are even more imprecise than data on FDI flows because there are differences in the method of valuation. Also depends on how disinvestments and reinvested earnings are recorded. Moreover, confusion is also generated by the different currencies in which investments might be recorded. It is possible to find data from the 1990s that were recorded in Deutsche Marks. Later sources from the early 2000s might have used US dollars, whereas after 2003 most foreign investment flows were recorded in euros. Compiling data and presenting them in a comparable manner would be almost impossible in this case. Luckily, reliable data on FDI stocks can be obtained from the National Trade Register Office, making compilation from different sources
unnecessary unless the researcher is interested in the historical evolution of the FDI stocks.

Another important source of data is media analysis. Media (political and financial newspapers, weekly economic magazines, online publications, etc.) are a great source of information whenever access to official statistics is difficult or whenever certain types of data are not collected and recorded by the agencies. The problem with using such sources, however, is that sometimes they mention merely intentions of foreign investors, before any capital is actually invested and it is very difficult for the researcher to verify whether these investments have eventually materialized. Although I made every effort to verify each piece of information by trying to confirm it from other sources, it is still possible that some information may be outdated.
Chapter 5: THE GEOGRAPHICAL DYNAMICS AND CHARACTERISTICS OF FDI IN ROMANIA

In Chapter 3, I discussed the political and economic transformation of Romania over the last two centuries with a special emphasis on the transition period starting with 1990. This provided the basis for understanding the geographical dynamics of FDI in Romania which will be discussed in this chapter. In the first part of this chapter I will examine the evolution of inward FDI since 1990. Then I will analyze the characteristics of inward FDI and of foreign-owned companies in Romania focusing on the average size of investment and sectors of investment while in the last part of this chapter I will discuss the geographic distribution of inward FDI in Romania and analyze the importance of FDI for different regions and counties.

5.1 The Evolution of the Inward FDI Stock since 1990

For many years inward FDI flows stayed very low although more foreign companies have been registered in Romania than in most European countries. FDI flows started to increase significantly only after 2002. By 2004, Romania ranked third in Central and Eastern Europe, after Russia and Poland but before Czech Republic and Hungary. However, in terms of the FDI stock per capita Romania is still well behind most Central European countries (figure 5.1). Three periods could be differentiated in the evolution of FDI inflows in Romania: 1990-1996, 1997-2002 and after 2002.
Figure 5.1: FDI stock per capita in Central and Southeastern Europe. Source: UNCTAD (2006).

5.1.1 The 1990-1996 Period

This period was characterized by stable and relatively attractive legislation pertaining foreign direct investments. This has attracted a great number of very small investors⁷⁹ (over 45,000 which is more than anywhere else in Central and Eastern Europe) but annual FDI flows and inward stock remained quite low due to the fact that very few large corporations were interested in investing in Romania (table 5.1; figures 5.2-5.5).

⁷⁹ Most of the investments were made by small firms or foreign individuals (Matei 2004)
<table>
<thead>
<tr>
<th>Year</th>
<th>Total Investment (in million USD)</th>
<th>No. of companies started</th>
<th>Rate of increase from previous year (in percentage)</th>
<th>Investment</th>
<th>No. of companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>40</td>
<td>5499</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>77</td>
<td>11765</td>
<td>92.5</td>
<td>113.9</td>
<td></td>
</tr>
<tr>
<td>1993</td>
<td>94</td>
<td>10583</td>
<td>22.1</td>
<td>- 10.0</td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td>341</td>
<td>11053</td>
<td>262.8</td>
<td>4.4</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>419</td>
<td>3400</td>
<td>22.9</td>
<td>- 69.2</td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>263</td>
<td>3630</td>
<td>- 37.2</td>
<td>6.8</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>1215</td>
<td>5251</td>
<td>362.0</td>
<td>44.7</td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td>2031</td>
<td>8801</td>
<td>67.2</td>
<td>67.6</td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>1041</td>
<td>7383</td>
<td>- 48.7</td>
<td>- 16.1</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>1037</td>
<td>8567</td>
<td>- 0.4</td>
<td>16.0</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>1157</td>
<td>7175</td>
<td>11.6</td>
<td>- 16.2</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>1144</td>
<td>7518</td>
<td>- 0.6</td>
<td>4.8</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>2213</td>
<td>6609</td>
<td>93.4</td>
<td>- 12.1</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>6517</td>
<td>10167</td>
<td>294.5</td>
<td>53.8</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>6388</td>
<td>11719</td>
<td>- 2.0</td>
<td>15.3</td>
<td></td>
</tr>
<tr>
<td>Total 1991-2005</td>
<td>23977</td>
<td>119120</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 5.1: Dynamics of FDI in Romania between 1991 and 2005. Sources: UNCTAD (2006), and National Trade Register Office (2006).
Figure 5.2: Annual FDI inflows in Romania between 1991 and 2005 (in millions USD).
Source: UNCTAD (2006)

Figure 5.3: Inward FDI stock in Romania between 1991 and 2005.
Source: UNCTAD (2006)
Figure 5.4: Number of foreign companies registered annually in Romania between 1991 and 2005.
Source: National Trade Register Office (2006).

Figure 5.5: Evolution of the total number of foreign firms in Romania between 1991 and 2005.
Source: National Trade Register Office (2006).
Large foreign corporations started coming to Romania much later than in Hungary or Czech Republic for several reasons. Firstly, the country was considered too risky for large greenfield investments or acquisition of state-owned enterprises given the general attitude of the population towards foreign investments, especially in the political realm (Bonciu 2003). “We won’t sell our country” was a very popular slogan of the early 1990s. This reluctance to sell state-owned assets is not characteristic of Romania solely (Sinn and Weichenrieder 1997); all Central European countries went through this stage, but in Romania this negative attitude towards foreign investors interested in acquiring Romanian state companies lasted longer. Moreover, unions were very strong, opposing job reductions or other measures taken to increase efficiency but which would have also affected the benefits and privileges of the workers. Frequent strikes in this period scared many potential investors away. Also, Romania was governed until 1996 by a center-left party which had many former communist party officials in its upper echelon. This raised many questions about the government’s commitment for political and economic reforms. Another issue that increased the risk for foreign investors is that before 1997 foreigners could not own land or real estate in Romania (Bonciu 2003).

Relatively few state-owned companies offered for privatization were of interest for foreign investors (table 5.2). None of the banks or the so-called regii autonome were open to privatization. In most Central European countries privatization of banks, utility or telecommunication companies started in 1994-1995 or earlier, whereas in Romania such privatization began only in 1998 (Bonciu 2003). The very high inflation rate (164.4 percent between 1991 and 1996) made it
very difficult for foreign investors to make decent profits on their investment (table 5.3a).\textsuperscript{80} Finally, due to the low buying power of the population the Romanian market was too small to attract many large market-driven corporations.

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of companies privatized</td>
<td>268</td>
<td>614</td>
<td>682</td>
<td>1351</td>
<td>1268</td>
<td>1461</td>
<td>5659</td>
<td>1345</td>
<td>53</td>
<td>12701</td>
</tr>
<tr>
<td>FDI in billion lei</td>
<td>13.6</td>
<td>143.1</td>
<td>588.1</td>
<td>1.157.7</td>
<td>4567.9</td>
<td>6569.8</td>
<td>6795.7</td>
<td>4563.1</td>
<td>1399.9</td>
<td>25798.7</td>
</tr>
</tbody>
</table>

Table 5.2: Number of enterprises privatized between 1993 and 2001.
Source: Autoritatea pentru Privatizare si Administrarea Patrimoniului Statului (found in Bonciu 2003).
*For 2001 data refers to the period between January and May

<table>
<thead>
<tr>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation rate</td>
<td>5.1</td>
<td>170.2</td>
<td>210.4</td>
<td>256.1</td>
<td>136.8</td>
<td>32.2</td>
<td>56.9</td>
<td>124.0</td>
<td>164.4</td>
</tr>
</tbody>
</table>

Table 5.3a: Rate of inflation in Romania between 1990 and 1996
Source: National Institute of Statistics

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation rate</td>
<td>151.5</td>
<td>40.7</td>
<td>56.1</td>
<td>45.7</td>
<td>73.5</td>
<td>34.1</td>
<td>22.5</td>
<td>15.3</td>
<td>9.3</td>
<td>8.6</td>
<td>4.8</td>
</tr>
</tbody>
</table>

Table 5.3b: Rate of inflation in Romania between 1997 and 2006
Source: National Institute of Statistics

5.1.2 The 1997-2002 Period

New elections in 1996 brought a new government. The new center-right government decided to speed up the process of privatization (table 5.2). As a direct effect FDI

\textsuperscript{80} An American investment banker once calculated that if the inflation rate is 60 percent and the investor has a target return of 40 percent (which would be normal considering the high risk of his investment) he needs an investment return in lei of 238 percent which few legitimate businesses can hope to make (Voicu 2000: 18).
inflows increased to over $1 billion annually in this period. Larger companies were privatized to foreign investors during this time period, including strategic companies like Romtelecom and the Romanian Bank for Development (BRD). However, annual inflows could have been much higher had it not been for very frequently changing legislation (see Chapter 3).

Another event that may have had a negative effect on inward FDI is the dissolution of the Romanian Agency for Development, the agency that was in charge with dealing with foreign investors and which was praised internationally for its professionalism (Bonciu 2003). Until 2002 when the Romanian Agency for Foreign Investments was created, this role was assumed by several ministries and governmental agencies. The relationship with foreign investors suffered because of a lack of coordination between all these ministries and agencies and the lack of a clear and unitary strategy. Also in 1997, the government guaranteed equal treatment for foreign and domestic investors but this generally meant that the incentives for foreign investors were reduced drastically (Bonciu 2003).

Many foreign investors (in general small investors) withdrew from Romania in this time period and relatively little investment came from new foreign companies; most of the investment between 1998 and 2002 was generated by existing companies that decided to expand (Bonciu 2003). Also during this period Romania experienced negative economic growth which attracted those companies

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81 Between 1991 and 1997 most of the investment was generated by new foreign companies (Bonciu 2003).
82 The ratio investment from existing companies to investment from new companies was 6 to 1 (Bonciu 2003: 221).
seeking cost-efficiency while market seeking companies decided to put their investment plans on hold (Voinea 2002).

5.1.3 After 2002
Starting with 2003, annual inward FDI flows to Romania have increased substantially reaching over US$6 billion in 2004 and 2005. As a result FDI inward stock increased almost three-fold at the end of 2005 against 2002. One important reason for this could be linked to Romania’s decision to join the Euro-Atlantic structures. As mentioned in the previous chapter, this had a twofold impact on foreign investments. On the one hand Romania started adopting the European legislation which made the business environment more predictable and more foreign investor-friendly while on the other hand many foreign investors were encouraged to locate here by the prospects of Romania eventually joining the European Union. Also, while there were fewer state-owned companies left for privatization, these were worth more and substantially increased the annual FDI flows.

The more stringent European legislation made it very difficult for Romanian firms to survive without a fresh infusion of capital and technology. This triggered a series of acquisitions of Romanian firms by foreign (and especially European) companies, particularly in the more sensitive sectors like the food industry which is heavily regulated in the European Union. This time period has been characterized by healthy growth rates for the Romanian economy\(^3\) and dropping inflation rates which contributed to increased consumption and attracted mainly market-oriented

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\(^3\) Average rate of economic growth for the period 2001-2006 was 5.8 percent, one of the highest in Europe (Richardson 2006).
foreign companies. As more multinational corporations decided to invest in Romania average size of investment also increased significantly and this will be discussed next.

5.2 The size of companies with foreign capital

By September 30th 2006, there were almost 130,000 companies with foreign capital registered in Romania, with an average of $147,000 investment/project (The National Trade Register Office 2006). While these numbers may project an over-optimistic image of Romania’s attractiveness for foreign investors, one has to keep in mind that many of these investments are very, very small. In many cases the foreign share of the capital invested amounts to less than $100 (The National Trade Register Office 2006, 2005, 2004, 2003, 2002, 2001). There are more foreign companies in Romania than in the European Union or the United States, which is also a good hint of the size of these companies (table 5.4).
Zolnowski (2002) showed that, out of 43,736 companies with foreign participation in Poland, only 14,244 (or less than one third) were actually operating in 2000. Thus, he argued that the registration of a company does not automatically mean that the company will commence an economic activity. Likewise, a study published in the Romanian financial weekly, Capital (2001), showed that approximately half of the 79,000 companies with foreign capital that existed in 2001 had no activity whatsoever.

It should also be noted that average foreign direct investment has increased considerably since 1991. That year the average foreign direct investment was only
US$7,474 and dropped to US$6,777 in 1992 after which it followed an ascending trajectory to reach over US$200,000 in 2005 (table 5.5). The explanation for the very low average investment in the early 1990s resides in the fact that most of these investments were directed to sectors like retail, tourism, certain services as well as food processing and textile sectors which can function with less capital. Another characteristic of FDI in Romania especially in the 1990s is that many foreign-owned firms were active in more than one economic sector (Popescu 1998). For example, one company may own a small retail store but also be involved in various industrial activities. This strategy is used to mitigate the risk of owning a business in an unpredictable economy and also take advantage of opportunities that may arise in different economic sectors at different times.

<table>
<thead>
<tr>
<th>Year</th>
<th>Inward FDI stock (in millions USD)</th>
<th>No. of companies</th>
<th>Average investment per company (in USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>40</td>
<td>5,499</td>
<td>7,474</td>
</tr>
<tr>
<td>1992</td>
<td>117</td>
<td>17,264</td>
<td>6,777</td>
</tr>
<tr>
<td>1993</td>
<td>211</td>
<td>27,847</td>
<td>7,577</td>
</tr>
<tr>
<td>1994</td>
<td>552</td>
<td>38,900</td>
<td>14,190</td>
</tr>
<tr>
<td>1995</td>
<td>971</td>
<td>42,300</td>
<td>22,955</td>
</tr>
<tr>
<td>1996</td>
<td>1,234</td>
<td>45,930</td>
<td>27,240</td>
</tr>
<tr>
<td>1997</td>
<td>2,449</td>
<td>51,181</td>
<td>47,849</td>
</tr>
<tr>
<td>1998</td>
<td>4,480</td>
<td>59,982</td>
<td>74,689</td>
</tr>
<tr>
<td>1999</td>
<td>5,521</td>
<td>67,365</td>
<td>81,956</td>
</tr>
<tr>
<td>2000</td>
<td>6,558</td>
<td>75,932</td>
<td>86,366</td>
</tr>
<tr>
<td>2001</td>
<td>7,715</td>
<td>83,107</td>
<td>92,832</td>
</tr>
<tr>
<td>2002</td>
<td>8,859</td>
<td>90,625</td>
<td>97,754</td>
</tr>
<tr>
<td>2003</td>
<td>11,072</td>
<td>97,234</td>
<td>113,869</td>
</tr>
<tr>
<td>2004</td>
<td>17,589</td>
<td>107,401</td>
<td>163,769</td>
</tr>
<tr>
<td>2005</td>
<td>23,977</td>
<td>119,120</td>
<td>201,284</td>
</tr>
</tbody>
</table>

Table 5.5: Average investment per company (in USD) between 1991-2005. Sources: UNCTAD (2006) and National Trade Register Office (2006).
Tables 5.6 and 5.7 show the distribution of foreign investments in Romania based on the employment it generated and respectively the amount of foreign capital invested. Data is available for only 53,027 firms (or less than half of all foreign companies registered with the National Trade Register Office in 2005) which are considered active meaning that they have reported a financial balance.

<table>
<thead>
<tr>
<th>Type of enterprise</th>
<th>Number of companies with foreign capital</th>
<th>Percentage of total</th>
<th>Capital invested by foreign companies</th>
<th>Percentage of total</th>
<th>Average investment per type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Micro-enterprises (1-9 employees)</td>
<td>42,484</td>
<td>80.1</td>
<td>1,787,898,783</td>
<td>13.2</td>
<td>42,084</td>
</tr>
<tr>
<td>Small enterprises (10-49 employees)</td>
<td>7,016</td>
<td>13.2</td>
<td>1,039,808,928</td>
<td>7.7</td>
<td>148,205</td>
</tr>
<tr>
<td>Medium enterprises (50-249 employees)</td>
<td>2,762</td>
<td>5.2</td>
<td>2,198,290,711</td>
<td>16.1</td>
<td>795,905</td>
</tr>
<tr>
<td>Large enterprises (250+ employees)</td>
<td>765</td>
<td>1.5</td>
<td>8,554,847,982</td>
<td>63.0</td>
<td>11,182,807</td>
</tr>
<tr>
<td>Total</td>
<td>53,027</td>
<td>100.0</td>
<td>13,580,846,404</td>
<td>100.0</td>
<td>256,112</td>
</tr>
</tbody>
</table>

Table 5.6: Distribution of FDI stock in Romania based on the size of the enterprise (number of employees)
Source: National Trade Register Office (2006)

<table>
<thead>
<tr>
<th>Type of investment</th>
<th>Number of investments</th>
<th>Percentage of total</th>
<th>Capital invested</th>
<th>Percentage of total</th>
<th>Average investment per type</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under USD 10,000</td>
<td>41,968</td>
<td>79.1</td>
<td>37,691,725</td>
<td>0.3</td>
<td>898</td>
</tr>
<tr>
<td>USD 10,000-100,000</td>
<td>7,105</td>
<td>13.3</td>
<td>266,422,592</td>
<td>2.0</td>
<td>37,498</td>
</tr>
<tr>
<td>USD 100,000-500,000</td>
<td>2,449</td>
<td>4.6</td>
<td>506,255,872</td>
<td>3.7</td>
<td>206,719</td>
</tr>
<tr>
<td>USD 500,000-1,000,000</td>
<td>525</td>
<td>1.3</td>
<td>373,520,597</td>
<td>2.7</td>
<td>711,468</td>
</tr>
<tr>
<td>Over USD 1,000,000</td>
<td>980</td>
<td>1.7</td>
<td>12,396,955,618</td>
<td>91.3</td>
<td>12,649,954</td>
</tr>
<tr>
<td>Total</td>
<td>53,027</td>
<td>100.0</td>
<td>13,580,846,404</td>
<td>100.0</td>
<td>256,112</td>
</tr>
</tbody>
</table>

Table 5.7: Distribution of FDI stock in Romania based on the size of the investment. Source: National Trade Register Office (2006)

Almost 80 percent of all foreign firms have invested less than US$10,000 each, the average investment in this category being less than US$900 (table 5.7). Since most of the companies that registered with the National Trade Register Office but had no activity in 2005 are perhaps from this category means that the percentage
of investments under US$10,000 is probably much higher. On the other hand, there were only 980 foreign investments over US$1 million, a figure considered to have a significant impact on the economy (Table 5.7). However, these 980 investments represent more than 91 percent of the total FDI in Romania with an average investment of more than US$12.6 million.

When analyzing the amount of employment that these investments have generated, the situation is very similar with more than 80 percent of all active foreign investments being in the category of micro-enterprises (meaning that they have less than ten employees) whereas only 765 foreign-owned enterprises or 1.5 percent could be considered large (with more than 250 employees). These, however represent 63 percent of all FDI in Romania (table 5.6).

The very small size of many of these investments and the high number of inactive firms suggest that at least some may be of a speculative character. Many foreign citizens may have taken advantage of the low requirements to register a company in Romania, but they have not started any activity yet perhaps waiting for more favorable times and conditions. There were also reports that companies registered as foreign-owned were used for money laundering or tax evasion (Matei 2004: 174). The media reported about numerous cases when Romanian business owners who failed to pay taxes several years and accumulated huge debts to suppliers and providers of services have sold their firms to foreign citizens (generally from the Middle East or the Republic of Moldova) who then disappeared and no one could be held responsible (Capital 2000).
While micro-enterprises and investments under US$10,000 represent the great majority of foreign firms, large enterprises and investments over US$1 million concentrate the bulk of the foreign capital invested. This polarization of foreign investments in micro and large enterprises is common for transition economies because here market mechanisms and institutions are not fully functional (Matei 2004 and Voicu 2000: 4). The reasons for this are very clearly synthesized by Voicu (2000: 4):

“On the one hand, the large multinational corporations can survive in relatively hostile conditions as they are able to follow long-term strategies while accommodating short-term losses during the first years of operation. In addition, they can cope relatively easily with the lack of country specific knowledge by having better access to the local governmental institutions and to adequate technical and legal consulting. On the other hand, small foreign investors can operate in a transition economy due to their small inertia: they do not undertake large investment projects with long technological cycles and therefore are able to take advantage of favorable market circumstances when they occur.”

5.3 Distribution of FDI by Sector of Activity

Almost 40 percent of the companies with foreign ownership are in trade (wholesale trade 27.1 percent and retail trade 12.3 percent). Most of these companies are small and medium-sized. As starting such a business did not entail large capital needs and was less risky than investments in industry, most foreign investments have been in this sector. Only 18.0 percent of companies declared their main activity as being in industry while 23.5 percent were active in services. These are followed by companies active in tourism (5.7 percent), construction (5.6 percent), agriculture
(4.5 percent), and transport (3.4 percent) (National Trade Register Office 2006; figure 5.6).

Figure 5.6: Distribution of Companies with Foreign Capital by Sector of Activity in Percentages (1991-Oct. 2006).
Source: National Trade Register Office (2006)

When considering the amount of capital investment, the situation changes completely. Half of all FDI inflows have been directed towards industry and only 12.8 percent towards trade (wholesale trade 7.5 percent and retail trade 5.3 percent). Services received 26.5 percent of the total FDI and transport 6.7 percent. Least attractive for FDI have been construction (1.6 percent), tourism (1.5 percent), and agriculture (with a mere 0.9 percent) (National Trade Register Office 2006; figure
5.7). This shows that average investments in industry are much larger than average investments in trade.

Figure 5.7: Inward FDI by Sector of Activity in Percentages (1991- Oct. 2006). Source: National Trade Register Office (2006)

More important than analyzing present sectoral distribution of FDI is tracking the changes in the sectoral distribution over time (tables 5.8 and 5.9). Several trends are visible. Firstly, in the early 1990s, foreign direct investments in the wholesale, retail and food industry were dominant, suggesting that the main motivation of foreign investors was to serve the domestic market. The Romanian economy in the early transition stage was characterized by a shortage of consumer goods, and especially basics like food and clothing. The first foreign companies in
Romania were established to import and distribute products made in other countries. In addition this type of investment required less capital and was less risky.

<table>
<thead>
<tr>
<th>Economic Sector</th>
<th>Distribution of Companies (in percentages)</th>
<th>Percentage Foreign Capital Invested</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale Trade</td>
<td>41.3</td>
<td>39.3</td>
</tr>
<tr>
<td>Retail Trade</td>
<td>24.6</td>
<td>19.4</td>
</tr>
<tr>
<td>Industry</td>
<td>15.9</td>
<td>19.1</td>
</tr>
<tr>
<td>Services</td>
<td>8.5</td>
<td>8.6</td>
</tr>
<tr>
<td>Transportation</td>
<td>3.4</td>
<td>3.0</td>
</tr>
<tr>
<td>Agriculture</td>
<td>3.1</td>
<td>4.5</td>
</tr>
<tr>
<td>Construction</td>
<td>2.3</td>
<td>2.7</td>
</tr>
<tr>
<td>Tourism</td>
<td>0.9</td>
<td>3.6</td>
</tr>
</tbody>
</table>

Table 5.8: Changes in the sectoral distribution of foreign-owned companies and foreign capital
Sources: National Trade Register Office (2006; 2001; 1999)
<table>
<thead>
<tr>
<th>Economic Sector</th>
<th>Percentage Foreign Capital Invested</th>
</tr>
</thead>
<tbody>
<tr>
<td>Food Industry</td>
<td>15.6</td>
</tr>
<tr>
<td>Machine Building</td>
<td>12.4</td>
</tr>
<tr>
<td>Tourism</td>
<td>5.7</td>
</tr>
<tr>
<td>Light industry (including textile, garments and footwear)</td>
<td>5.2</td>
</tr>
<tr>
<td>Banking</td>
<td>4.5</td>
</tr>
<tr>
<td>Transportation</td>
<td>4.2</td>
</tr>
<tr>
<td>Mining</td>
<td>3.8</td>
</tr>
<tr>
<td>Services</td>
<td>3.8</td>
</tr>
<tr>
<td>Electronics</td>
<td>2.7</td>
</tr>
<tr>
<td>Agriculture</td>
<td>2.1</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>0.9</td>
</tr>
<tr>
<td>Other (including retail and wholesale trade)</td>
<td>39.1</td>
</tr>
</tbody>
</table>

Table 5.9: Sectoral distribution of foreign capital in 1996

Later, an increasing number of multinational corporations, like Coca Cola decided to produce locally rather than import. They were encouraged to do so by the stability of the political environment and by the positive feedback received from the consumers. The higher percentage of foreign capital invested in the food and light industries in 1996 is a result of these changes (table 5.9). Since then the importance of industry has constantly increased especially in terms of the capital invested (table 5.8). This is due to the significant privatization of FDI in this sector, especially in
late 1990s and early 2000s, and the increasing number of greenfield projects afterwards.

Romania is the only country in Southeastern Europe that has built an export-oriented sector (Hunya 2004a). This was possible not only because of a lower salary base\textsuperscript{84} than in Central European countries but also because access to western markets is more facile than from other countries in the area that were affected by wars or civil conflicts.

More than 50 percent of the manufacturing output was realized by companies with foreign ownership in 2002, employing one-third of the manufacturing workforce (Hunya 2004a). In 2000, 44 percent of the manufacturing exports were realized by these enterprises (Hunya 2004a). Most of these investments are in low-tech, labor-intensive industries. So far foreign investors have been less interested in the high-tech sector. In the electronics sector, for instance they control a share of only two percent (Marinescu 2003).

On the other hand, the importance of retail and wholesale trade has continuously decreased in spite of numerous multinationals entering the Romanian market (table 5.8). Another visible trend is the boom in the number of foreign companies in the service sector, a development that is consistent with the world trend (UNCTAD 2004; table 5.8). The capital invested in the service sector has also increased significantly, partly due to the privatization of several major Romanian banks and acquisition of privately-owned Romanian banks by foreign banks. With rising incomes, Romanians have more money to spend. In addition banks, foreign

\textsuperscript{84} However, labor costs must be assessed together with productivity levels. In Romania, due to low productivity, unit labor costs are less than 20 percent of the Austrian level (Landesmann and Stehrer 2003 cited in Hunya 2004b).
and domestic, compete fiercely on offering loans for a variety of purposes from purchasing a home or a car to paying for a dream vacation. This explains the substantial positive change in the number of foreign companies in the construction and tourism sectors. However, these firms being generally small, the increase in their number is not reflected also in increased percentage of foreign capital in these two sectors.

5.4 Geographic Distribution of FDI

The inward FDI stock is distributed very unevenly across the country with most of it being absorbed by the city of Bucharest. Capital cities collect the lion’s share of all FDI in all Eastern European countries (Turnock 2001a). This is not surprising as capital cities concentrate an important percentage of the country’s population, represent the main economic center, the main research and education center and have the largest pool of skilled labor in the country. For instance, Prague absorbed 49 percent of all FDI into the Czech Republic by 2001 (down from 60 percent in the early 1990s) and with the surrounding region of Central Bohemia its share was 60 percent (Pavlinek 1998; 2004). In Hungary, Budapest concentrates over 60 percent of the inward FDI stock (van Hastenberg 1999). In Slovakia, more than half of the total FDI is located in Bratislava and, in general, there is a correlation between regional FDI inflows and the level of GDP/capita (Smith 1996; Hoskova 2001).

In Romania, more than 61,000 companies with foreign capital were registered in Bucharest between 1991 and 2005. These companies represent 51.8 percent of the total foreign enterprises in Romania. They brought together US$8.7
billion representing 52.2 percent of all FDI in the country (The National Trade Register Office 2006; table 5.10). If we consider the capital’s region, which comprises Bucharest and the small, mainly rural, county surrounding it (Ilfov), the numbers add up to 54.2 percent and 59.7 percent respectively (The National Trade Register Office 2006; table 5.10).

<table>
<thead>
<tr>
<th>Region</th>
<th>Companies with foreign participation (*)</th>
<th>Capital invested (**)</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percent of total</td>
<td>In mil. USD</td>
</tr>
<tr>
<td>Northeast</td>
<td>4,769</td>
<td>4.0</td>
<td>523.7</td>
</tr>
<tr>
<td>Southeast</td>
<td>6,496</td>
<td>5.5</td>
<td>1,483.6</td>
</tr>
<tr>
<td>South</td>
<td>4,781</td>
<td>4.0</td>
<td>1,663.2</td>
</tr>
<tr>
<td>Southwest</td>
<td>2,975</td>
<td>2.5</td>
<td>270.8</td>
</tr>
<tr>
<td>West</td>
<td>12,858</td>
<td>10.8</td>
<td>1,075.6</td>
</tr>
<tr>
<td>Northwest</td>
<td>11,622</td>
<td>9.8</td>
<td>912.2</td>
</tr>
<tr>
<td>Center</td>
<td>11,132</td>
<td>9.3</td>
<td>811.5</td>
</tr>
<tr>
<td>Bucharest-Ilfov</td>
<td>64,507</td>
<td>54.2</td>
<td>9,990.9</td>
</tr>
<tr>
<td>Bucharest city</td>
<td>61,687</td>
<td>51.8</td>
<td>8,735.0</td>
</tr>
<tr>
<td>Romania</td>
<td>119,120</td>
<td>100</td>
<td>16731.6</td>
</tr>
</tbody>
</table>

Table 5.10: Number of registered foreign companies with foreign capital investment and the value of the invested capital, on economic development regions, between 1991 and 2005.
Source: National Trade Register Office (2006).

When analyzing the amount of capital invested, the region with least FDI was Southwest (Oltenia) which received only 1.6 percent of all FDI (The National
Trade Register Office 2006; table 5.10). Next to Southwest is Northeast (Moldova), a predominantly agricultural region which received only 3.1 percent of the total FDI in Romania (The National Trade Register Office 2006).

The most attractive regions based on capital invested are the South and the Southeast, with 9.9 and 8.9 percent respectively of the total FDI invested in Romania (The National Trade Register Office 2006; table 5.10). An important advantage of these regions in attracting FDI is their proximity to Bucharest so the investors have the advantage of proximity to the capital’s market while paying lower rents. But a closer look at these two regions would reveal that the higher FDI inflows here are determined by one large individual investment in each region. In Arges County (South), in 2003, of the total FDI invested in the county, $537 million or 87 percent came from one transaction: Renault’s (France) investment into the Romanian auto maker, Dacia. Also Galati County (Southeast) is fourth in the country in terms of total foreign investment (table 5.11). But more than $500 million, or 70 percent resulted from Mittal Steel (UK- India) buying and investing in Sidex, the largest Romanian steel maker.

---

85 In December 2005 data from the National Trade Register Office (2006) show Arges County with 1047 foreign firms which have invested a total of $952.8 million. On the other hand Renault claims that it has invested alone 800 million euros or $1,037.9 million in Arges County (interview with C. Stroe 2006).
### Table 5.11: Number of registered companies with foreign capital investment and the value of the invested capital between 1991 and 2005.

<table>
<thead>
<tr>
<th>County</th>
<th>Number of companies</th>
<th>Number</th>
<th>Amount of subscribed capital</th>
<th>Amount</th>
<th>Order by:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>%</td>
<td>Millions USD</td>
<td>%</td>
<td>Number</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>of companies</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Subscribed</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>capital</td>
</tr>
<tr>
<td>Alba</td>
<td>1119</td>
<td>0.9</td>
<td>68.5</td>
<td>0.4</td>
<td>17</td>
</tr>
<tr>
<td>Arad</td>
<td>3271</td>
<td>2.7</td>
<td>163.8</td>
<td>1.0</td>
<td>6</td>
</tr>
<tr>
<td>Arges</td>
<td>1047</td>
<td>0.9</td>
<td>952.8</td>
<td>5.7</td>
<td>19</td>
</tr>
<tr>
<td>Bacau</td>
<td>921</td>
<td>0.8</td>
<td>236.5</td>
<td>1.4</td>
<td>21</td>
</tr>
<tr>
<td>Bihor</td>
<td>3369</td>
<td>2.8</td>
<td>276.1</td>
<td>1.7</td>
<td>5</td>
</tr>
<tr>
<td>Bistrita-Nasaud</td>
<td>778</td>
<td>0.7</td>
<td>30.3</td>
<td>0.2</td>
<td>25</td>
</tr>
<tr>
<td>Botosani</td>
<td>322</td>
<td>0.3</td>
<td>14.8</td>
<td>0.1</td>
<td>36</td>
</tr>
<tr>
<td>Brasov</td>
<td>3175</td>
<td>2.7</td>
<td>283.5</td>
<td>1.7</td>
<td>7</td>
</tr>
<tr>
<td>Buzau</td>
<td>620</td>
<td>0.5</td>
<td>51.9</td>
<td>0.3</td>
<td>27</td>
</tr>
<tr>
<td>Caras-Severin</td>
<td>854</td>
<td>0.7</td>
<td>145.7</td>
<td>0.9</td>
<td>23</td>
</tr>
<tr>
<td>Calarasi</td>
<td>300</td>
<td>0.3</td>
<td>69.3</td>
<td>0.4</td>
<td>37</td>
</tr>
<tr>
<td>Cluj</td>
<td>4264</td>
<td>3.6</td>
<td>411.1</td>
<td>2.5</td>
<td>3</td>
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<tr>
<td>Constanta</td>
<td>3794</td>
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<td>599.9</td>
<td>3.6</td>
<td>4</td>
</tr>
<tr>
<td>Covasna</td>
<td>669</td>
<td>0.6</td>
<td>43.0</td>
<td>0.3</td>
<td>26</td>
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<tr>
<td>Dambovita</td>
<td>591</td>
<td>0.5</td>
<td>159.3</td>
<td>1.0</td>
<td>28</td>
</tr>
<tr>
<td>Dolj</td>
<td>1370</td>
<td>1.1</td>
<td>41.6</td>
<td>0.2</td>
<td>15</td>
</tr>
<tr>
<td>Galati</td>
<td>891</td>
<td>0.7</td>
<td>720.1</td>
<td>4.3</td>
<td>22</td>
</tr>
<tr>
<td>Giurgiu</td>
<td>346</td>
<td>0.3</td>
<td>14.8</td>
<td>0.1</td>
<td>35</td>
</tr>
<tr>
<td>Gorj</td>
<td>290</td>
<td>0.2</td>
<td>2.3</td>
<td>0.0</td>
<td>38</td>
</tr>
<tr>
<td>Harghita</td>
<td>1625</td>
<td>1.4</td>
<td>65.8</td>
<td>0.4</td>
<td>12</td>
</tr>
<tr>
<td>Hunedoara</td>
<td>1115</td>
<td>0.9</td>
<td>85.1</td>
<td>0.5</td>
<td>18</td>
</tr>
<tr>
<td>Ialomita</td>
<td>287</td>
<td>0.2</td>
<td>13.2</td>
<td>0.1</td>
<td>40</td>
</tr>
<tr>
<td>Iasi</td>
<td>1520</td>
<td>1.3</td>
<td>87.5</td>
<td>0.5</td>
<td>13</td>
</tr>
<tr>
<td>Maramures</td>
<td>1481</td>
<td>1.2</td>
<td>101.0</td>
<td>0.6</td>
<td>14</td>
</tr>
<tr>
<td>Mehedinți</td>
<td>486</td>
<td>0.4</td>
<td>30.7</td>
<td>0.2</td>
<td>30</td>
</tr>
<tr>
<td>Mures</td>
<td>2199</td>
<td>1.8</td>
<td>219.6</td>
<td>1.3</td>
<td>10</td>
</tr>
<tr>
<td>Neamt</td>
<td>786</td>
<td>0.7</td>
<td>86.2</td>
<td>0.5</td>
<td>24</td>
</tr>
<tr>
<td>Olt</td>
<td>352</td>
<td>0.3</td>
<td>144.7</td>
<td>0.9</td>
<td>34</td>
</tr>
<tr>
<td>Prahova</td>
<td>1955</td>
<td>1.6</td>
<td>401.8</td>
<td>2.4</td>
<td>11</td>
</tr>
<tr>
<td>Salaj</td>
<td>428</td>
<td>0.4</td>
<td>17.6</td>
<td>0.1</td>
<td>32</td>
</tr>
<tr>
<td>Satu Mare</td>
<td>1302</td>
<td>1.1</td>
<td>76.0</td>
<td>0.5</td>
<td>16</td>
</tr>
<tr>
<td>Sibiu</td>
<td>2345</td>
<td>2.0</td>
<td>131.0</td>
<td>0.8</td>
<td>9</td>
</tr>
<tr>
<td>Suceava</td>
<td>972</td>
<td>0.8</td>
<td>59.1</td>
<td>0.3</td>
<td>20</td>
</tr>
<tr>
<td>Teleorman</td>
<td>255</td>
<td>0.2</td>
<td>52.0</td>
<td>0.3</td>
<td>41</td>
</tr>
<tr>
<td>Timis</td>
<td>7618</td>
<td>6.4</td>
<td>682.1</td>
<td>4.1</td>
<td>2</td>
</tr>
<tr>
<td>Tulcea</td>
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<td>0.3</td>
<td>59.2</td>
<td>0.4</td>
<td>39</td>
</tr>
<tr>
<td>Vaslui</td>
<td>228</td>
<td>0.2</td>
<td>42.6</td>
<td>0.3</td>
<td>42</td>
</tr>
<tr>
<td>Valcea</td>
<td>477</td>
<td>0.4</td>
<td>51.4</td>
<td>0.3</td>
<td>31</td>
</tr>
<tr>
<td>Vrancea</td>
<td>391</td>
<td>0.3</td>
<td>21.4</td>
<td>0.1</td>
<td>33</td>
</tr>
<tr>
<td>Bucuresti</td>
<td>61687</td>
<td>51.8</td>
<td>8735.0</td>
<td>52.2</td>
<td>1</td>
</tr>
<tr>
<td>Ilfov</td>
<td>2820</td>
<td>2.4</td>
<td>1255.9</td>
<td>7.5</td>
<td>8</td>
</tr>
<tr>
<td>Romania</td>
<td>119120</td>
<td>100.0</td>
<td>16731.6</td>
<td>100.0</td>
<td>0</td>
</tr>
</tbody>
</table>

Moreover when the bulk of the FDI stock is made up by one major investment there could be very important variations over time. When Daewoo
invested in Automobile Craiova during mid 1990’s, Dolj County ranked very high among Romania’s counties in terms of inward FDI flows and stock\textsuperscript{86}. The disinvestment following the withdrawal of Daewoo from Automobile Craiova caused Dolj County to drop to a much lower position on the list (33\textsuperscript{rd} out of the 42 counties- table 5.11).

These considerations illustrate that the amount of invested capital is not necessarily a good indicator of regional attractiveness for foreign investors. In my opinion, the number of foreign companies registered could perhaps be a much more accurate indicator. Here the leaders (after Bucharest) are the West and Northwest regions, which were able to attract 10.8 percent and 9.8 percent respectively of foreign companies that came to Romania (National Trade Register Office 2006; table 5.10). Another Transylvanian region, the Center is fourth with 9.3 percent of companies, while Southeast, South and Northeast are far with 5.5, 4.0 and 4.0 percent of foreign companies respectively (The National Trade Register Office 2006). Southwest is again the least attractive region with only 2.5 percent of all foreign companies located there (The National Trade Register Office 2006).

Since these eight economic regions are not equal in terms of population, more accurate results could be obtained calculating the per capita investment and average population per foreign company. This confirms the supremacy of the capital with more than US$4,500 per capita followed by the West region with US$555, Southeast with US$520 and South with US$498 (table 5.9). The Southwest seems to be forty times less attractive than Bucharest- Ilfov Region with only US$117 per

\textsuperscript{86} In 1996 Dolj County ranked second (after Bucharest) with 7.8 percent of the FDI stock in Romania (Voicu 2000: 5)
capita (and more than four times less attractive than the West, Southeast, and South). Northeast also ranks low with only US$140 per capita (The National Trade Register Office 2006).

<table>
<thead>
<tr>
<th>Region</th>
<th>Population/foreign company</th>
<th>Invested Capital (in USD)/capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Northwest</td>
<td>236</td>
<td>333</td>
</tr>
<tr>
<td>West</td>
<td>151</td>
<td>555</td>
</tr>
<tr>
<td>Center</td>
<td>228</td>
<td>320</td>
</tr>
<tr>
<td>Northeast</td>
<td>784</td>
<td>140</td>
</tr>
<tr>
<td>Southeast</td>
<td>439</td>
<td>520</td>
</tr>
<tr>
<td>South</td>
<td>699</td>
<td>498</td>
</tr>
<tr>
<td>Southwest</td>
<td>779</td>
<td>117</td>
</tr>
<tr>
<td>Bucharest- Ilfov</td>
<td>34</td>
<td>4,526</td>
</tr>
<tr>
<td>Romania</td>
<td>182</td>
<td>772</td>
</tr>
</tbody>
</table>

Table 5.12: Density of companies with foreign capital.
Source: National Trade Register Office (2006)

If we analyze the population per foreign company indicator, Bucharest is again leader with one foreign company for 34 people followed by the three regions in Transylvania (West, Northwest and Center) with one foreign company for 150-250 people each. The South, Southwest and Northeast seem less popular with the foreign investors having only one company for 700-800 people (The National Trade Register Office 2006).

While this shows a general tendency for foreign investors to prefer certain regions, there are important differences even within regions (figures 5.8 and 5.9). In the West Region, for instance, in Timis County there is one foreign company for 87 people (table 5.10). In the same region, but in Hunedoara County there is one foreign company for 435 people. In the Northwestern region, in Cluj County there is one foreign company for 161 people, in Salaj County one for 579 people. In the
Northeast region, in Iasi County there is one foreign company for each 540 people while in Botosani County this number climbs up to 1/1426 and in Vaslui County to 1/2014. In the South, while Prahova County has a decent density of foreign companies (1/424), in Teleorman County there is only one foreign enterprise for 1677 people. In the Southwest, Dolj County has attracted one company with foreign capital for every 526 people, while in Gorj and Olt there is no more than one company for more than 1300 people registered. Gorj is actually the least attractive county in Romania for FDI with only $2.3 million inward stock in 16 years (The National Trade Register Office 2006).
<table>
<thead>
<tr>
<th>County</th>
<th>Reg.</th>
<th>Population</th>
<th>Population/company *</th>
<th>FDI stock/population **</th>
<th>Rank by:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alba</td>
<td>Center</td>
<td>382,971</td>
<td>342</td>
<td>179</td>
<td>15</td>
</tr>
<tr>
<td>Arad</td>
<td>W</td>
<td>460,466</td>
<td>141</td>
<td>356</td>
<td>4</td>
</tr>
<tr>
<td>Arges</td>
<td>S</td>
<td>647,437</td>
<td>618</td>
<td>1472</td>
<td>23</td>
</tr>
<tr>
<td>Bacau</td>
<td>NE</td>
<td>722,961</td>
<td>785</td>
<td>327</td>
<td>29</td>
</tr>
<tr>
<td>Bihor</td>
<td>NW</td>
<td>596,961</td>
<td>177</td>
<td>462</td>
<td>6</td>
</tr>
<tr>
<td>Bistrita-Nasaud</td>
<td>NW</td>
<td>318,558</td>
<td>409</td>
<td>95</td>
<td>17</td>
</tr>
<tr>
<td>Botosani</td>
<td>NE</td>
<td>459,195</td>
<td>1426</td>
<td>32</td>
<td>40</td>
</tr>
<tr>
<td>Brasov</td>
<td>Center</td>
<td>396,140</td>
<td>188</td>
<td>476</td>
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</tr>
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<td>Braila</td>
<td>SE</td>
<td>371,749</td>
<td>727</td>
<td>84</td>
<td>28</td>
</tr>
<tr>
<td>Buzau</td>
<td>SE</td>
<td>495,878</td>
<td>800</td>
<td>105</td>
<td>30</td>
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<tr>
<td>Caras-Severin</td>
<td>W</td>
<td>332,688</td>
<td>390</td>
<td>438</td>
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<td>Calarasi</td>
<td>S</td>
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<td>1062</td>
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<td>Cluj</td>
<td>NW</td>
<td>686,825</td>
<td>161</td>
<td>599</td>
<td>5</td>
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<tr>
<td>Constanta</td>
<td>SE</td>
<td>713,825</td>
<td>188</td>
<td>840</td>
<td>9</td>
</tr>
<tr>
<td>Covasna</td>
<td>C</td>
<td>223,878</td>
<td>335</td>
<td>192</td>
<td>13</td>
</tr>
<tr>
<td>Dambovita</td>
<td>S</td>
<td>538,126</td>
<td>910</td>
<td>296</td>
<td>34</td>
</tr>
<tr>
<td>Dolj</td>
<td>SW</td>
<td>720,554</td>
<td>526</td>
<td>58</td>
<td>20</td>
</tr>
<tr>
<td>Galati</td>
<td>SE</td>
<td>621,161</td>
<td>697</td>
<td>1159</td>
<td>25</td>
</tr>
<tr>
<td>Giurgiu</td>
<td>S</td>
<td>288,018</td>
<td>832</td>
<td>51</td>
<td>31</td>
</tr>
<tr>
<td>Gorj</td>
<td>SW</td>
<td>386,097</td>
<td>1331</td>
<td>6</td>
<td>38</td>
</tr>
<tr>
<td>Harghita</td>
<td>C</td>
<td>328,547</td>
<td>202</td>
<td>200</td>
<td>10</td>
</tr>
<tr>
<td>Hunedoara</td>
<td>W</td>
<td>484,767</td>
<td>435</td>
<td>176</td>
<td>19</td>
</tr>
<tr>
<td>Ialomita</td>
<td>S</td>
<td>293,102</td>
<td>1021</td>
<td>45</td>
<td>36</td>
</tr>
<tr>
<td>Iasi</td>
<td>NE</td>
<td>821,621</td>
<td>540</td>
<td>106</td>
<td>21</td>
</tr>
<tr>
<td>Maramures</td>
<td>NW</td>
<td>516,562</td>
<td>349</td>
<td>195</td>
<td>14</td>
</tr>
<tr>
<td>Mehedinti</td>
<td>SW</td>
<td>305,901</td>
<td>629</td>
<td>100</td>
<td>24</td>
</tr>
<tr>
<td>Mures</td>
<td>C</td>
<td>384,089</td>
<td>266</td>
<td>376</td>
<td>11</td>
</tr>
<tr>
<td>Neamt</td>
<td>NE</td>
<td>570,367</td>
<td>726</td>
<td>151</td>
<td>27</td>
</tr>
<tr>
<td>Olt</td>
<td>SW</td>
<td>488,176</td>
<td>1387</td>
<td>296</td>
<td>39</td>
</tr>
<tr>
<td>Prahova</td>
<td>S</td>
<td>829,026</td>
<td>424</td>
<td>484</td>
<td>18</td>
</tr>
<tr>
<td>Salaj</td>
<td>NW</td>
<td>247,796</td>
<td>579</td>
<td>71</td>
<td>22</td>
</tr>
<tr>
<td>Satu Mare</td>
<td>NW</td>
<td>371,759</td>
<td>285</td>
<td>204</td>
<td>12</td>
</tr>
<tr>
<td>Sibiu</td>
<td>C</td>
<td>423,535</td>
<td>181</td>
<td>309</td>
<td>7</td>
</tr>
<tr>
<td>Suceava</td>
<td>NE</td>
<td>705,202</td>
<td>725</td>
<td>84</td>
<td>26</td>
</tr>
<tr>
<td>Teleorman</td>
<td>S</td>
<td>427,745</td>
<td>1677</td>
<td>122</td>
<td>41</td>
</tr>
<tr>
<td>Timis</td>
<td>W</td>
<td>661,593</td>
<td>87</td>
<td>1031</td>
<td>2</td>
</tr>
<tr>
<td>Tulcea</td>
<td>SE</td>
<td>253,419</td>
<td>877</td>
<td>234</td>
<td>33</td>
</tr>
<tr>
<td>Vaslui</td>
<td>NE</td>
<td>459,255</td>
<td>2014</td>
<td>93</td>
<td>42</td>
</tr>
<tr>
<td>Valcea</td>
<td>SW</td>
<td>416,908</td>
<td>874</td>
<td>123</td>
<td>32</td>
</tr>
<tr>
<td>Vrancea</td>
<td>SE</td>
<td>394,286</td>
<td>1008</td>
<td>54</td>
<td>35</td>
</tr>
<tr>
<td>Bucuresti</td>
<td>Buc-</td>
<td>1,927,559</td>
<td>31</td>
<td>4532</td>
<td>1</td>
</tr>
<tr>
<td>Ilfov</td>
<td>Ilfov</td>
<td>280,037</td>
<td>99</td>
<td>4485</td>
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</tr>
<tr>
<td>Romania</td>
<td></td>
<td>21,673,328</td>
<td>182</td>
<td>772</td>
<td></td>
</tr>
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</table>

Table 5.13: Density of companies with foreign companies.  
Source: Author’s calculations based on data from National Trade Register Office (2006) and National Institute of Statistics (2006).
Figure 5.8: Population per foreign company. 
Source: Author’s calculations based on data from the National Trade Register Office (2006) and Romanian National Institute of Statistics (2006).

Figure 5.9: FDI Stock per Population. 
Source: Author’s calculations based on data from the National Trade Register Office (2006) and Romanian National Institute of Statistics (2006).
Another useful indicator is the FDI stock as a percentage of GDP which shows the importance of FDI for local economies. In only three regions this percentage is higher than the national average. It is the highest in the Bucharest-Ilfov Region and in the regions surrounding it (the South and Southeast) (table 5.14). In the Southeast Region, FDI stock represents 45 percent of GDP in Galati County due mostly to the significant foreign investment in Mittal Steel (table 5.15). This percentage is also remarkable in Constanta County, which has a strong manufacturing industry that has developed around the port and which has attracted strong flows of FDI. In the South Region, heavy investments in Arges County focused especially on automotive industry represents almost 30 percent of this county’s GDP. Also above the national average are Calarasi and Dambovita counties (table 5.15).

On the other hand, in five counties FDI stock represents less than one percent of GDP. In all these counties the primary sector is dominant or very significant. More surprising is the position of Iasi county ranking 37th with its inward FDI stock representing only one percent of GDP in 2003. Iasi City is the second largest city in Romania after Bucharest and has historically been the capital of the province of Moldova (including roughly the Northeast Region and a small part of the Southeast Region). However, the amount of FDI stock in this county is low compared to the level of economic development.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Bucharest- Ilfov</td>
<td>18.2</td>
</tr>
<tr>
<td>2.</td>
<td>Southeast</td>
<td>15.4</td>
</tr>
<tr>
<td>3.</td>
<td>South</td>
<td>12.2</td>
</tr>
<tr>
<td>4.</td>
<td>Northwest</td>
<td>5.4</td>
</tr>
<tr>
<td>5.</td>
<td>West</td>
<td>5.2</td>
</tr>
<tr>
<td>6.</td>
<td>Northeast</td>
<td>3.2</td>
</tr>
<tr>
<td>7.</td>
<td>Central</td>
<td>2.9</td>
</tr>
<tr>
<td>8.</td>
<td>Southwest</td>
<td>2.2</td>
</tr>
<tr>
<td></td>
<td>Romania</td>
<td>9.0</td>
</tr>
</tbody>
</table>

Table 5.14: Inward FDI Stock as a Percentage of GDP (1991-2003) in the eight development regions in Romania.
Sources: Author’s calculations based on data from the National Trade Register Office (2004) and the Romanian National Institute of Statistics (2006)
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Galati</td>
<td>45.0</td>
<td>23.</td>
<td>Vaslui</td>
<td>2.3</td>
</tr>
<tr>
<td>2.</td>
<td>Arges</td>
<td>28.5</td>
<td>24.</td>
<td>Sibiu</td>
<td>2.2</td>
</tr>
<tr>
<td>3.</td>
<td>Ilfov</td>
<td>24.8</td>
<td>25.</td>
<td>Alba</td>
<td>2.1</td>
</tr>
<tr>
<td>4.</td>
<td>Bucharest</td>
<td>17.8</td>
<td>26.</td>
<td>Covasna</td>
<td>2.0</td>
</tr>
<tr>
<td>5.</td>
<td>Constanta</td>
<td>17.2</td>
<td>27.</td>
<td>Hunedoara</td>
<td>2.0</td>
</tr>
<tr>
<td>7.</td>
<td>Dambovita</td>
<td>11.7</td>
<td>29.</td>
<td>Giurgiu</td>
<td>1.9</td>
</tr>
<tr>
<td>8.</td>
<td>Timis</td>
<td>8.4</td>
<td>30.</td>
<td>Braila</td>
<td>1.9</td>
</tr>
<tr>
<td>9.</td>
<td>Prahova</td>
<td>8.1</td>
<td>31.</td>
<td>Salaj</td>
<td>1.8</td>
</tr>
<tr>
<td>10.</td>
<td>Bihor</td>
<td>7.1</td>
<td>32.</td>
<td>Suceava</td>
<td>1.6</td>
</tr>
<tr>
<td>11.</td>
<td>Olt</td>
<td>7.0</td>
<td>33.</td>
<td>Dolj</td>
<td>1.5</td>
</tr>
<tr>
<td>12.</td>
<td>Maramures</td>
<td>6.5</td>
<td>34.</td>
<td>Valcea</td>
<td>1.3</td>
</tr>
<tr>
<td>13.</td>
<td>Cluj</td>
<td>6.4</td>
<td>35.</td>
<td>Caras-Severin</td>
<td>1.2</td>
</tr>
<tr>
<td>15.</td>
<td>Neamt</td>
<td>5.5</td>
<td>36.</td>
<td>Tulcea</td>
<td>1.2</td>
</tr>
<tr>
<td>16.</td>
<td>Arad</td>
<td>4.7</td>
<td>37.</td>
<td>Iasi</td>
<td>1.0</td>
</tr>
<tr>
<td>17.</td>
<td>Mures</td>
<td>4.5</td>
<td>38.</td>
<td>Bistrita-Nasaud</td>
<td>0.9</td>
</tr>
<tr>
<td>18.</td>
<td>Teleorman</td>
<td>3.7</td>
<td>39.</td>
<td>Vrancea</td>
<td>0.6</td>
</tr>
<tr>
<td>19.</td>
<td>Satu Mare</td>
<td>3.4</td>
<td>40.</td>
<td>Botosani</td>
<td>0.5</td>
</tr>
<tr>
<td>20.</td>
<td>Mehedinti</td>
<td>3.3</td>
<td>41.</td>
<td>Ialomita</td>
<td>0.5</td>
</tr>
<tr>
<td>21.</td>
<td>Harghita</td>
<td>2.9</td>
<td>42.</td>
<td>Gorj</td>
<td>0.1</td>
</tr>
<tr>
<td>22.</td>
<td>Brasov</td>
<td>2.6</td>
<td>43.</td>
<td>Romania</td>
<td>9.0</td>
</tr>
</tbody>
</table>

Table 5.15: Inward FDI stock as a percentage of GDP (1991-2003) in the 42 counties in Romania
Sources: Author’s calculations based on data from the National Trade Register Office (2004) and the Romanian National Institute of Statistics (2006)
5.5 Conclusion

The purpose of this chapter was to analyze the dynamics and main characteristics of FDI in Romania between 1991 and 2005. Until 1996 inward FDI flows remained very low due to the fact that the very numerous foreign-owned companies registered in Romania in this period were mainly very small. Few large companies invested in Romania during the first half of the 1990s, not least because the privatization of state-owned enterprises was moving very slowly. Beginning in 1997, the privatization process accelerated and annual FDI inflows increased significantly to stabilize between US$1 billion and US$2 billions. After 2002, the prospect of joining NATO and the EU made Romania more attractive in the eyes of foreign investors and annual FDI inflows increased six fold between 2002 and 2004.

Most of the approximately 120,000 foreign companies registered in Romania by the end of 2005 were very small. But, average investment per company has increased constantly, especially after 1996 as Romania started to privatize larger and more important state-companies. While 80 percent of all active foreign investments are very small, the bulk of the inward FDI stock is given by very large enterprises. Almost 40 percent of all foreign-owned companies are involved in the wholesale and retail trade but 50 percent of the foreign capital has been invested in industry. Recently, the importance of wholesale and retail trade has decreased in spite of numerous multinational chains having entered the Romanian market while the percentage FDI in the service sector has constantly increased.

The distribution of inward FDI stock is very uneven with more than 50 percent being concentrated in Bucharest. While the South and Southeast rank right
behind the Bucharest-Ilfov Region based on inward FDI stock, the West, Northwest and Center Regions have attracted the most foreign investors (after Bucharest-Ilfov Region). The Northeast and Southwest Regions are the least attractive regions for foreign investors and have received the smallest amounts of foreign capital.
Chapter 6: GEOGRAPHICAL ORIGIN OF FDI INTO ROMANIA

This chapter examines and compares the geographical origins of foreign direct investment (FDI) into Romania. Companies are founded and develop in a home nation environment before expanding abroad. They are therefore “expected to bear at least traces of the economic, social and cultural characteristics of their home territory” (Dicken et al 1994: 34; Dicken 2003; 1998; Doremus et al 1998). On these grounds, we could expect that the characteristics of foreign-owned companies in Romania and their distribution may be affected to an extent by the social-cultural milieus of their countries of origin. The relationship between the geographical distribution of foreign investments and countries of origin is also examined. Historical factors as well as cultural similarities may help to explain the concentration of companies from a country in certain regions or counties.

In the first part of the chapter I provide an overview of the distribution of FDI in Romania based on the investors’ country of origin. I focus my analysis on two indicators: the number of companies and the amount of capital invested. Then I provide an in-depth analysis for a number of selected FDI-source countries. For each of these countries I analyze the number of companies operating in Romania, the amount of capital invested, and the average size of investment. I also examine the geographical distribution of foreign investments for each of the selected countries, both in terms of companies and capital invested. I then assess the importance of investments from particular countries based on their location quotients. Using secondary sources, I explore general associations between country of origin and economic sectors and type or mode of investment, such as market-
driven or resource-driven; the structure of ownership – whether 100 percent-owned versus joint venture; the nature of the activity in terms of labor, technology and capital intensiveness; and the mode of entry into Romania, i.e. whether as greenfield investment or by acquisition. In the last part of this chapter, I synthesize the information in order to compare characteristics of FDI from the selected countries in three areas: a) average size of investment; b) mode of investment; and c) geographical distribution of investment.

6.1 FDI by Countries of Origin

As of 30 September 2006 there were almost 130,000 foreign-owned companies in Romania. These companies have invested a total of almost USD 19 billion since 1991. The fifty countries that have invested the most money in Romania are presented in Table 6.1. The Netherlands ranks first with more than $3.9 billion invested, followed by Austria (almost $2.5 billion), France (almost $2 billion), Germany ($1.75 billion) and Italy (over $1 billion). These five countries contribute 59 percent of total FDI (The National Trade Register Office 2006; table 6.1), and they are home to more than one third of the total number of countries that have invested in Romania.
Rank

1.
2.
3.
4.
5.
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10.
11.
12.
13.
14.
15.
16.
17.
18.
19.
20.
21.
22.
23.
24.
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26.
27.
28.
29.
30.
31.
32.
33.
34.
35.
36.
37.
38.
39.
40.
41.
42.
43.
44.
45.
46.
47.
48.
49.
50.

Countries

Amount of
capital invested
(thousands
USD)

Percentage of
total FDI
stock

Number
companies

Percentage
Total

Total
Netherlands
Austria
France
Germany
Italy
United Kingdom
U.S.A.
Dutch Antilles
Cyprus
Greece
Turkey
Switzerland
Hungary
British Virgin
Islands
Spain
China
Luxemburg
Sweden
Japan
Belgium
Without
Citizenship
Liechtenstein
South Korea
Lebanon
Syria
Canada
Marshall Islands
Israel
Iraq
Poland
Ireland
Denmark
Norway
Panama
Moldova
Iran
Jordan
Slovenia
Argentina
Portugal
Gibraltar
Iceland
Finland
Egypt
Lithuania
Australia
Thailand
New Zealand
United Arab
Emirates
Serbia

18,816,474.9
3,900,306.0
2,448,595.6
1,969,631.1
1,755,393.5
1,011,413.0
847,881.9
837,144.5
712,067.6
676,043.5
655,078.4
571,156.5
535,204.4
430,393.9
412,932.3

100.0
20.73
13.01
10.47
9.33
5.38
4.51
4.45
3.78
3.59
3.48
3.04
2.84
2.29
2.19

128,146
2,584
3,984
4,527
13,861
20,697
2,520
4,788
12
2,196
3,502
9,461
1,637
6,226
245

295,208.2
210,953.1
205015.9
123,619.0
96,649.2
87,017.7
79,303.9

1.57
1.12
1.09
0.66
0.51
0.46
0.42

77,060.9
62,047.8
61,558.4
61,346.1
59,464.3
50,784.9
48,989.6
42,355.5
36,808.9
35,239.1
31,378.6
19,826.3
19,205.7
18,682.6
18,093.5
17,482.5
16,763.1
14,767.8
13,359.4
12,495.1
12,416.1
12,241.0
12,103.5
11,945.9
11,896.6
11,633.5
11,619.4
10,871.9
10,019.5

Rank

100.0
2.02
3.11
3.53
10.82
16.15
1.97
3.74
0.01
1.71
2.73
7.38
1.28
4.86
0.19

Average
investment in a
foreign
company
(USD)
146,836
1,509,406
614,607
435,085
126,643
48,867
336,461
174,842
59,338,966
307,852
187,058
60,370
326,942
69,128
1,685,437

5
8
15
28
39
17
24
1
20
22
35
18
34
4

1,583
8,504
374
905
190
1,671
23

1.24
6.64
0.29
0.71
0.15
1.30
0.02

186,486
24,806
548,171
136,596
508,680
52,075
3,447,996

23
40
10
27
12
37
3

0.41
0.33
0.33
0.33
0.32
0.27
0.26
0.23
0.20
0.19
0.17
0.11
0.10
0.10
0.10
0.09
0.09
0.08
0.07
0.07
0.07
0.07
0.06
0.06
0.06
0.06
0.06
0.06

169
101
3,219
5,070
1,196
11
3,754
5,193
312
425
389
191
132
2,474
2,458
2,956
78
29
185
38
25
73
1,221
30
504
15
17
191

0.13
0.08
2.51
3.96
0.93
0.01
2.93
4.05
0.24
0.33
0.30
0.15
0.10
1.93
1.92
2.31
0.06
0.02
0.14
0.03
0.02
0.06
0.95
0.02
0.39
0.01
0.01
0.15

455,981
614,334
19,123
12,100
49,719
4,616,809
13,050
8,156
117,977
82,916
80,664
103,803
145,498
7,552
7,361
5,914
214,912
509,234
72,213
318,818
496,644
167,685
9,913
398,197
23,604
775,567
683,494
56,921

14
9
42
45
38
2
44
47
29
31
32
30
26
48
49
50
21
11
33
19
13
25
46
16
41
6
7
36

0.05

741

0.58

13,522

43

Table 6.1: Foreign Direct Investment in Romania by country of origin ranked by
amount of capital invested (30 September 2006) (from the National Trade Register
Office 2006)

153


Looking at these figures at a broad regional scale reveals that the significant majority, 65.6 percent of companies and 83.8 percent of FDI are European in origin. A significant minority of companies (27.0 percent) are Asian (mainly from China and the Middle East). However, many of these companies are very small. Their total investments represent less than 4 percent (3.7%) of total FDI. North America accounts for 3.7 percent of the companies and 4.7 percent of the capital invested. Overall the OECD is the dominant economic group in terms of FDI origins, with 65.3 percent of companies and 82.1 percent of the investments derived from OECD countries. Furthermore within this group the EU accounts for 51.6 percent of the total number of companies and 76.3 percent of total FDI (The National Trade Register Office 2006; 2005; table 2).

One major problem when analyzing the geographical origin of foreign direct investment is that the origin of the capital does not always match the investor’s country of origin. One would hardly expect countries and territories like the Marshall Islands, the Dutch Antilles, the British and American Virgin Islands or the Cayman Islands to have the financial strength and interest to invest in Eastern Europe. Instead they serve as off-shore banks for sizable companies from elsewhere. In contrast, although Russian companies like Lukoil or Gazprom have made significant investments in Romania, Russia is not listed among the top 50 countries of origin. It is difficult to track this accurately, but it is most likely that the capital to finance these investments was channeled through other countries. During the 1990s the Russian owners of the newly privatized state-owned enterprises were known to engage in massive capital flight to protect their newly acquired riches with Cyprus.
and Switzerland serving as two of the preferred destinations. According to Bradshaw (2002) these two countries figure among the top ten foreign investors in Russia, evidence perhaps of the growing importance of a reversal of capital flight (Bradshaw 2002). It is possible that at least some of the capital derived from these two countries represents the interests of Russian investors. Examples of cases where foreign investment is derived from third countries, i.e. countries other than the home country of the parent investor are illustrated in table 6.2:
<table>
<thead>
<tr>
<th>Foreign Company</th>
<th>Acquired Romanian Company</th>
<th>Country origin foreign company</th>
<th>Country origin-Capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mittal Steel (today Arcelor Mittal)</td>
<td>Ispat Sidex</td>
<td>U.K./India</td>
<td>Dutch Antilles and Switzerland</td>
</tr>
<tr>
<td>Wienerberger</td>
<td>greenfield</td>
<td>Austria</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>Italsofa</td>
<td>greenfield</td>
<td>Italy</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Papastratos</td>
<td>greenfield</td>
<td>Greece</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Lukoil</td>
<td>greenfield</td>
<td>Russia</td>
<td>Netherlands</td>
</tr>
<tr>
<td>OTE</td>
<td>Romtelecom</td>
<td>Greece</td>
<td>Cyprus</td>
</tr>
<tr>
<td>Michelin</td>
<td>Tofan Group</td>
<td>France</td>
<td>United Kingdom Switzerland</td>
</tr>
<tr>
<td>Lear Corporation</td>
<td>greenfield</td>
<td>USA</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Finansbank</td>
<td>greenfield</td>
<td>Turkey</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Alcoa-Fujicura</td>
<td>greenfield</td>
<td>USA-Japan</td>
<td>Germany</td>
</tr>
<tr>
<td>Procter &amp; Gamble</td>
<td>greenfield</td>
<td>USA</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Dow Chemical</td>
<td>greenfield</td>
<td>USA</td>
<td>Netherlands</td>
</tr>
<tr>
<td>SEWS (Sumitomo)</td>
<td>greenfield</td>
<td>Japan</td>
<td>United Kingdom</td>
</tr>
<tr>
<td>Takata Petri</td>
<td>greenfield</td>
<td>Japan</td>
<td>Germany</td>
</tr>
<tr>
<td>Pirelli Tyres Romania</td>
<td>greenfield</td>
<td>Italy</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Honeywell Garrett</td>
<td>greenfield</td>
<td>USA</td>
<td>Dutch Antilles</td>
</tr>
<tr>
<td>Oracle</td>
<td>greenfield</td>
<td>USA</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Philip Morris Romania</td>
<td>greenfield</td>
<td>USA</td>
<td>Netherlands</td>
</tr>
<tr>
<td>Saint Gobain Glass Romania</td>
<td>greenfield</td>
<td>France</td>
<td>Poland</td>
</tr>
<tr>
<td>DHL</td>
<td>greenfield</td>
<td>Germany</td>
<td>Netherlands</td>
</tr>
</tbody>
</table>

Table 6.2: Selected FDI transactions
Source: Data collected from the National Trade Register Office (2006; 2005; 2004; 2003; 2002).

In this next section I analyze the patterns of foreign investment from the five most significant countries of origin – Netherlands, Austria, France, Germany and Italy. All are West European and in order to diversify the analysis four additional countries are also selected. The United States provides a non-European example,
while Hungary, Turkey and Greece are regional investors with the potential for a rather different set of investment and location dynamics.

### 6.1.1 Dutch FDI

The Netherlands ranks first among investing countries in Romania with more than 2,500 companies that together have invested almost US$4 billion between 1991 and 2006 (table 6.1). Many other multinational corporations have invested in Romania through their branches in the Netherlands (table 6.2). These events are recorded as Dutch investments even though the parent headquarters are located elsewhere.

Bucharest city is home to more than 40 percent of all Dutch companies (figure 6.1; table 6.5). The remainder is distributed among the other seven regions with no one region being particularly favored. Around 60 percent of Dutch FDI has been invested in Bucharest (figure 6.2). Other counties that have received more than US $25 million in Dutch investment are dispersed between six of the eight regions. Analysis of location quotients\(^{87}\) for Dutch FDI reveals that no one particular region stands out (figure 6.3).

Dutch investments in Romania are generally large\(^{88}\), averaging over US $1.5 million (table 6.1). Some of the largest and more important Dutch companies are found in banking (ING Bank and ABN Amro Bank), insurance (ING Nederlanden), securities (ING Securities), consulting (KPMG, Lugera & Makler), logistics (Frans Maas, Rynart), shipyards (Damen Shipyards Group), electronics (Philips),

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\(^{87}\) Location quotients are calculated as \(LQ = (FCC/TFC)/(FCR/TFR)\); where FCC = Number of foreign companies from that country in a county; TFC = Total number of foreign companies in that county; FCR = total number of foreign companies from that country in Romania; TFR = total number of foreign companies in Romania.

\(^{88}\) The Netherlands rank fifth in terms of average investment (table 2).
construction (Den Braven Solid Works, and Remco Building) and the chemicals sector (Poly Delta Chemicals) ( Romanian Foreign Affairs, http://www.mae.ro; Larive Romania 2006; Mihaescu 2004). There are also a significant number of Dutch companies in food processing. Since entering the Romanian market in 2001, for example, Friesland Coberco has become one of the most important firms in the dairy products industry, competing among others, with the Dutch company, Dutch Group Campina (Larive Romania 2006). Heineken is a strong player in the highly competitive Romanian beer market (http://www.mae.ro). Unilever has also invested approximately US$108 million and is one of the largest investors in Romania in the production and distribution of margarine, detergents and cosmetics (Larive Romania 2006; http://www.mae.ro).

Figure 6.1: The distribution of Dutch-owned companies in Romania.
Note: There are 886 Dutch companies in Bucharest and 62 in Ilfov County.
Source: National Trade Register Office (2006).
Figure 6.2: Dutch investment in Romania.
Source: National Trade Register Office (2006).

Figure 6.3: Location quotients for Dutch FDI.
Source: National Trade Register Office (2006)
6.1.2 Austrian FDI

Austrian FDI in Romania has increased substantially in the last few years following two important acquisition events. The first was the acquisition by OMV\(^89\) of the Romanian national petroleum company (Petrom) for US$2 billion, and the second was Erste Bank’s acquisition of the Commercial Bank of Romania for US$3 billion. Austria currently ranks second among investing countries in Romania with almost US$2.5 billion (table 6.1). Due to these two major acquisitions the average Austrian investment of US$615,000 is larger than that for most of its European countries counterparts with the exception of the Netherlands.

Most Austrian investment in Romania appears to be market-driven\(^90\). Lower labor costs are generally less significant for Austrian companies given their high levels of automation (Marin 2006). Furthermore Austria’s relatively small domestic market means that the emergent countries in Eastern Europe are seen as markets as opposed to labor supplies. For this reason Austrian companies are less sensitive to rising labor costs or the appreciation of the Romanian currency. Indeed rising wages can work in the interests of such firms, because they enhance the purchasing power of the population and market potential (Nine O’ Clock 2006b). Also, most Austrian companies prefer greenfield investments. According to Munteanu, “this way

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\(^{89}\) Oesterreichischen Mineraloelverwaltung Aktiengesellschaft.

\(^{90}\) However, the larger Austrian companies focus on the entire region (Southeast Europe for instance, or Eastern Europe) rather than just the Romanian market. Due to its strategic position (with access to the Danube River- through which it is directly connected to Austria - and the Black Sea, Romania is attractive to Austrian companies as an industrial platform for supplying other markets in the region (Munteanu 2003).
investors bypass the problem of moving into a run-down plant and inheriting the festering union problems that usually come with it” (Munteanu 2003: 2).

Bucharest accounts for a quarter of all Austrian firms and a remarkable 95 percent of Austrian FDI invested in Romania (table 6.5). Beyond Bucharest, Austrian investors have tended to prefer Transylvania (Northwest, Center and West Regions) (figure 6.4). Together these three regions have attracted together more than 43 percent of all Austrian companies operating in Romania. Location quotients are also highest in Transylvania, suggesting that historical and cultural factors may have played an important role in Austrian investors’ decision to invest there (figure 6.6). Lately more Austrian investors are looking to the east. Suceava County is particularly important here given Austria’s historic ties through the province of Bukovina. Iasi is also relatively popular among Austrian investors due to the presence of numerous universities and colleges, giving them access to a large pool of educated and qualified labor (Marin 2005; figure 6.4). In terms of the capital invested, Bucharest and the surrounding counties have attracted the lion’s share, with Transylvania serving as a very distant second (figure 6.5).

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91 Another reason for Austrian investors preference for Transylvania, according to Franz Bachleitner, commercial councilor at the Austrian Embassy in Bucharest, is because of the poor state of the Romanian infrastructure (especially roads); transport costs are prohibitive for many Austrian companies (Munteanu 2003)

92 From 1775 to 1918 Bukovina, which incorporates territories that are today part of the Ukraine and Romania (what is today Suceava County) was the easternmost crown land of the Austrian Empire.
Figure 6.4: Austrian firms in Romania.
Source: National Trade Register Office (2006).

Figure 6.5: Capital invested by Austrian firms (millions USD).
Source: National Trade Register Office (2006)
The banking sector was clearly favored when examining the distribution of capital invested by sector. Three major Austrian banks have operations in Romania: Erste Bank (which took over Banca Comerciala Romana), Raiffeisen Bank (which owns Banca Agricola) and Volksbank. Also more than 50 insurers from Austria are now operating in Romania (Munteanu 2003).

Another sector that has seen significant Austrian investment is the wood processing and furniture industry. Several companies including Holzindustrie Schweinengofer, Kronospan, and Bene Romania are operating in Romania. Indeed Austria has a long industrial tradition in this sector and more Austrian companies are expected to show interest in Romania as Romsilva loses its monopoly on the administration of Romanian forests (Marin 2006).
Several large Austrian companies are involved in the construction and building material sector. Bramac, Baumit, Austrotherm and Wienerberger are among the leaders in this sector (Nine O’ Clock 2006). Wienerberger has invested $50 million in two brick factories at Gura Ocnitei, Dambovita County (greenfield investment) and Sibiu (through acquisition of a Cema company) and today it is the most important producer of bricks in Romania (www.wienerberger.ro). Another Austrian company, Strabag AG is heavily involved in several motorway projects in Romania.

6.1.3 French FDI

France represents the third largest set of investments in Romania with over 4,500 firms and almost US$2 billion invested. The high average investment - $435,000 – points to the significance of a small number of large multinational corporations. Some of the largest French investors in Romania are presented in Table 6.3 below.
<table>
<thead>
<tr>
<th>Company</th>
<th>Parent Company</th>
<th>Sector</th>
<th>Type of Investment</th>
<th>Amount invested (in millions of Euro)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orange Romania</td>
<td>France Telecom</td>
<td>Telecommunication</td>
<td>Acquisition</td>
<td>1,000</td>
</tr>
<tr>
<td>Dacia-Renault</td>
<td>Renault</td>
<td>Automotive</td>
<td>Acquisition of the Dacia car maker</td>
<td>845</td>
</tr>
<tr>
<td>Societe Generale BRD</td>
<td>Societe Generale</td>
<td>Banking</td>
<td>Acquisition of the second largest Romanian bank (at that time), BRD (The Romanian Bank for Development)</td>
<td>830</td>
</tr>
<tr>
<td>Lafarge Ciment(^93) (Romania)</td>
<td>Lafarge</td>
<td>cement</td>
<td>Acquisition in 1997 of Romcim, at the time the largest Romanian cement producer (three operations in Romania at Medgidia, Hoghiz and Targu Jiu)</td>
<td>320</td>
</tr>
<tr>
<td>Veolia Environment(^94)</td>
<td>Veolia Environment</td>
<td>Municipal Water and Sewage</td>
<td>Acquisition of Apa Nova. Long-term contract with the Cities of Bucharest and Ploiesti</td>
<td>135</td>
</tr>
<tr>
<td>Carrefour Romania</td>
<td>Carrefour</td>
<td>retailing</td>
<td>greenfield</td>
<td>160</td>
</tr>
<tr>
<td>Saint Gobain</td>
<td>Saint Gobain</td>
<td>glass</td>
<td>greenfield</td>
<td>100</td>
</tr>
<tr>
<td>Alcatel Romania</td>
<td>Alcatel-Lucent</td>
<td>telecommunications</td>
<td>greenfield</td>
<td>45</td>
</tr>
<tr>
<td>Danone</td>
<td>Danone</td>
<td>Dairy production</td>
<td>greenfield</td>
<td>30</td>
</tr>
<tr>
<td>Total 9 major companies</td>
<td></td>
<td></td>
<td></td>
<td>3,465</td>
</tr>
</tbody>
</table>

Table 6.3: Selected French corporations in Romania ranked by capital invested

Source: www.roumanie.com

It is worth noting that total investment for these nine corporations adds to almost 3.5 billion euros\(^95\) which considerably exceeds total French investment in Romania recorded by the National Trade Register Office. This suggests that an important segment of investments made by French companies in Romania were

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\(^93\) Known as Lafarge Romcim until 2006.

\(^94\) Until 2003 known as Vivendi Environment.

\(^95\) Based on the currency exchange from February 8, 2007 this would represent over US$4.5 billion. However, these investments were made over many years when currency exchange rates varied.
channeled through third country subsidiaries. Another possible reason for the discrepancy may be the way in which The National Trade Register Office calculates total inward investment made by a foreign company. The French Economic Mission in Bucharest claims that inward FDI in Romania is severely underestimated because the National Trade Register Office does not include in their calculation of FDI local financing, through reinvested profits or loans contracted with local banks (Mission Economique de Bucarest-Roumanie 2006). The French Economic Mission has estimated French FDI in Romania to be around 3.5 billion euros which is more consistent with the figures listed above (ibid).

French corporations have primarily been interested in the acquisition of privatizing companies, although more lately French companies have entered the Romanian market through greenfield investments (Larive Romania 2006). Of the 70,000 people employed by French companies in Romania, approximately 70 percent work in the formerly state-owned companies acquired by French investors (Mission Economique de Bucarest- Roumanie 2006).

There are French investments in virtually all economic sectors, especially in manufacturing and service activities. The economic sectors with the most French FDI are the automotive industry (besides the Renault Group several other companies were established in Romania including Valeo, Michelin, Faurecia, Auto Chassis International, SNR and Plastique Forme), telecommunications (Orange-France Telecom and Alcatel), utilities (Veolia Environment and Gaz de France which has acquired Distrigaz Sud), construction materials (Lafarge and Saint

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96 Several French retail companies have financed their expansion on the Romanian market with loans from local banks. The National Trade Register Office did not record them as foreign direct investment because the capital to finance expansion was not transferred from abroad (Marin 2006b).
Gobain), food processing (for example Danone), banking (BRD-Societe Generale and BNP Paribas which owns Credisson) and hotel chains such as Accor (Mission Economique de Bucarest- Roumanie 2006).

French retailers also have very strong positions in the Romanian market. Carrefour (owned by Hyparlo) has eleven hypermarkets in Romania. Louis Delhaize has also invested heavily in Romania with three Cora hypermarkets and 24 Profi supermarkets and also has plans to expand. Other retailers with expansion plans include Intermarche and the DIY (do-it-yourself) superstore Bricostore (Euromonitor 2006). Bricostore (owned by Bresson) has seven superstores in Romania and plans to add three to five units per year. A second French DIY chain, Mr. Bricolage has also entered the Romanian market by means of franchising (Euromonitor 2006). In April 2006, the largest commercial center in Romania (36,000 sq.m.), built by the French company Vinci, opened in Bucharest. It has 77 stores anchored by Carrefour and Bricostore (Smart Financial 2006)

Small and medium-sized French enterprises have tended to favor small-town locations where they play an important economic role (Prol-position 2005). Many of these firms are in the textile, garments and footwear sector (e.g. Union Textile de Tourcoing, Lainiere de Picardie, Gout among others), furniture (Mobilux which belongs to the Parisot Group and produces furniture for Ikea, Conforama and Mobexpert; MTI and Plexirom), mechanical industries (Loire Etude Outillage and

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97 Auchan and Leclerc are also expected to enter the Romanian market (Euromonitor 2006).
98 Their store in Romania is called Brico Expert.
99 In its final form, Feeria Commercial Center will have 170,000 sq. m. and will be the largest commercial center in Central and Eastern Europe (Smart Financial 2006).
Ius Outillage), electrical industries (Energom and Bleu Electrique) and software (Gameloft) (Mission Economique de Bucarest-Roumanie 2006).

In many ways the pattern of investment on the part of French investors is opposite to that of their Austrian counterparts. While the city of Bucharest has attracted almost 40 percent of all French companies operating in Romania it accounts for only 20 percent of total French FDI (figures 6.7, 6.8 and 6.9). More than half of all French FDI (53.6 percent) has been invested in Arges County, the majority of which is in the automotive industry. Some neighboring counties, such as Brasov and Sibiu have also received significant FDI from France.

Figure 6.7: French firms in Romania.
Source: National Trade Register Office (2006).
Figure 6.8: Capital invested by French firms.
Source: National Trade Register Office (2006)

Figure 6.9: Location quotients for French FDI.
Source: National Trade Register Office (2006)
6.1.4 German FDI

Germany ranks fourth in terms of the amount of capital invested (almost US$1.8 billion) and second, after Italy, in terms of the number of companies (over 13,000) (see table 6.1). According to Mr. Gheorghe Bivol, the economic attaché with the Romanian Embassy in Berlin, German firms have invested far more than the figures recorded by the National Trade Register Office as many German firms have invested through Dutch or Austrian subsidiaries (Bloombiz 2007).

Many of the US$1 million plus investments in Romania are German-owned although the bulk of German firms in Romania are small and owned by individuals rather than corporate entities. The average German investment in Romania is US$126,000 placing Germany 28th among the top 50 investing countries. However, more than 90 percent of all German investments in Romania are under US$50,000 (Larive Romania 2005). Most German investors invest in ventures that are 100 percent German owned and very few German companies in Romania are involved in joint ventures (Munteanu 2002).

Many German companies, especially in the manufacturing sector, are attracted to Romania because of low labor costs (Munteanu 2002). This is certainly the case with the textile and automotive sectors. However, some German investors are market-oriented, especially in fields like energy, pharmaceuticals and medicine, real estate, construction and retailing (Munteanu 2002).
There are German firms in virtually all economic sectors\textsuperscript{100} but more than 50 percent of all German FDI has been invested in manufacturing\textsuperscript{101}. One of the industrial sectors with a very strong German presence is the automotive sector.

About half of all foreign-owned automotive companies in Romania are German (see table 6.1 automotive) and together they have invested or pledged to invest more than US$1 billion. Most of these are in Transylvania and are export-oriented operations.

Retailing is another sector dominated by German firms\textsuperscript{102}. Metro AG was the first retail chain to invest in Romania in 1996 and today owns 23 cash and carry stores. The Metro Group has also entered the Romanian market with its DIY division, Praktiker, involving 16 stores with more than 1,600 employees and, very recently with its hypermarket division, Real, opening eight units in 2006. Metro is competing with another German group, Rewe. Rewe owns a cash and carry chain, Selgros which operates 17 stores in Romania and a supermarket chain - Penny Market - which operates 26 stores in 20 counties, mainly in small and medium-sized towns\textsuperscript{103}. Billa, an Austrian supermarket chain controlled by Rewe, has opened 28 stores in Romania (Popescu 2007b). Kaufland (part of the Schwartz Group) is another German retail company with a very aggressive expansion plan. By February

\textsuperscript{100} At the end of 2004 the sectoral distribution of German firms in Romania was as follows: 23 percent in manufacturing, 21 percent in wholesale, 17 percent in services, 16 percent in retail, seven percent in transport and communication, six percent in tourism and five percent each in construction and agriculture (Amos News 2005).

\textsuperscript{101} Of the almost US$1 billion invested by German companies between 1991 and 2004, 55.9 percent went to manufacturing, 17 percent to services, 11 percent to wholesale, 5.5 percent to the construction sector, 4.4 percent to retail, 2.9 percent to tourism, 1.9 percent to transport and 1.4 percent to agriculture (Amos News 2005).

\textsuperscript{102} Date and information collected for this section were drawn from the official websites of the following German retail companies (www.kaufland.ro; www.metro.ro; www.praktiker.ro; www.realhypermarket.ro; www.selgros.ro; www.xxlmegadiscount.ro; www.billa.ro; and www.tengelmann.de) as well as secondary data from Romanian newspapers.

\textsuperscript{103} Another chain owned by Rewe, XXL Megadiscount will re-branded as Penny Market XXL (Popescu 2007).
2008 it has already opened 31 hypermarkets, an investment of over 250 million euros (Ziarul Financiar 2007b; www.kaufland.ro). Also Plus Discount (owned by the Tengelmann Group) entered the Romanian market in 2005 and already operates 34 units. It plans to invest a further 300 million euros to reach 175 stores by 2009-2010 (David 2006).

Other economic sectors where German companies are well represented include the food industry (e.g. Dr. Oetker), finance\textsuperscript{104} and insurance (Allianz), cement (Heidelberg Cement) and the textile and garments industry with numerous small companies. More recently German firms have taken an interest in the Romanian energy sector. EON Energie has participated in the privatization of the Romanian energy companies and acquired majority shares in Electrica Moldova (a 100 million euro deal) and Distrigaz Nord (for which it paid more than 300 million euros). Several German investors, concerned with a potential European energy crisis have expressed interest in acquiring agricultural land to be used for the cultivation of bio-energy plants (Bloombiz 2007).

Other, less traditional sectors like waste management have also been explored by German investors. The Lobbe Group, one of the most important European waste management companies has announced its intent to invest about 100 million euros (US$130 million) in Romania in the next two or three years\textsuperscript{105} (Marin 2006c).

The majority (62.5 percent) of all German firms in Romania are in Transylvania (Northwest, Center and West regions) while Bucharest city accounts

\textsuperscript{104} However, in terms of banking only HVB is present in Romania.
\textsuperscript{105} The German group has already made its first move by acquiring 59 percent of shares in Vivani Salubritate from Slobozia (Ialomita County) in 2006 (Marin 2006).
for less than 20 percent of all German firms and 26 percent of German capital invested in Romania (figure 6.10). When considering the Bucharest Region more broadly, the numbers rise marginally to 21 percent and 31 percent respectively. In seven counties in Transylvania, German firms represent 20 percent or more of the total foreign firms and in Sibiu County almost half of all foreign firms are German (figure 6.12). In terms of capital invested two clusters are evident (figure 6.11). The primary cluster is again Transylvania and especially the West and Center Regions while Bucharest and several neighboring counties in the South Region represent the secondary cluster.

Figure 6.10: German firms in Romania.
Source: National Trade Register Office (2006).
Figure 6.11: Capital invested by German firms.
Source: National Trade Register Office (2006)

Figure 6.12: Location Quotients for German FDI.
Source: National Trade Register Office (2006)
6.1.5 Italian FDI

With more than 20,000 companies in Romania, Italy ranks first among investing countries on this measure. In terms of the capital invested by these companies, however, Italy ranks fifth with more than $1 billion (National Trade Register Office 2006; table 6.1). Most of the Italian companies in Romania are small or very small. Indeed the average Italian investment in Romania is less than $50,000\(^{106}\) (table 6.1). Italian multinational corporations are also present in Romania however. For example Enel, the Italian electricity company acquired two Romanian energy producers in 2004: Electrica Dobrogea and Electrica Banat and several other companies are expected to join in the next few years (Dialog Textil 2005).

There are Italian investments spread across all eight regions, but in the last ten years a concentration of Italian capital in the Western counties, especially in and around the city of Timisoara, has become evident\(^{107}\) (figure 6.14). This could be explained by Timisoara’s proximity to Northeast Italy, from where most Italian investors originate. Over 80 percent of all Italian companies investing in Romania are headquartered in Northeast Italy and 20 percent are from the province of Veneto alone (Stocchiero n.d.). Timisoara’s cosmopolitanism has also been an important factor in attracting foreign investors.\(^{108}\) Once a cluster of Italian investors has

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\(^{106}\) Average investments from the province of Veneto (which represent the majority of Italian investments in West Region) are even smaller (around US$20,000) (Antenna Veneto 2006).

\(^{107}\) In 2000, 10% of all Italian companies were registered in the city of Timisoara alone (Martin and Straubhaar 2002; Banat Business 2004).

\(^{108}\) Situated close to the borders with Hungary and Yugoslavia, Timisoara had historically been part of other states (Hungary, the Ottoman Empire, and Austria) before being annexed by Romania in 1918. Part of this heritage, there are several ethnic minorities (among which Hungarians, Germans, Serbians, Bulgarians, Gypsies, and Ukrainians are the most numerous) cohabiting with the Romanian majority population. Timisoara has always been cited as a model of ethnic and religious tolerance.
formed, this in itself seems to constitute an important attraction for other Italian firms.

Figure 6.13: Italian firms in Romania.
Source: National Trade Register Office (2006).

However, the success enjoyed by Timisoara in attracting investment is beginning to show certain strains. The unemployment rate in the city and the surrounding area is less than 3%\textsuperscript{109} (HotNews 2005; Ancutescu 2005).

Consequently, it is becoming increasingly difficult to find qualified workers in the area and wages have increased much faster than in other regions (Ancutescu 2005).

\textsuperscript{109} In Jimbolia, the unemployment rate is negative and many companies are forced to bus in workers from other regions.
Moreover, real estate prices have also risen sharply (Ancutescu 2005). In spite of the Mayor Gheorghe Ciuhandu’s assurances that Timisoara businesses are thriving, more and more Italian companies are threatening to relocate to other parts of Romania, or even move further east to the Republic of Moldova and the Ukraine (Majocchi 2004; Gandul 2006a).

In Cluj County, the number of firms with Italian capital has increased by 88 percent from 2005 to 2006 (Timoce 2006). Other counties in Eastern and Southern Romania have fewer Italian investments but these commonly represent an important percentage of total foreign companies and thus have a major impact on the economies of these counties (figure 6.15). In Olt and Vrancea for example Italian companies represent over 40 percent of all foreign companies. Certain counties in the Northeast and South regions along with Hunedoara County in the West Region have the “advantage” of higher unemployment rates and lower labor costs (Commercio Estero News 2002). If we consider the number of firms, then the sparsest Italian investments are in the Center Region as well as in Satu Mare and Constanta counties in the Northwest and Southeast Region respectively. These counties have important Hungarian, German or Turkish minorities and consequently numerous firms from those countries rather than from Italy (figure 6.13). Bucharest has attracted foreign firms from a wide variety of countries and therefore no particular country seems to dominate. However in terms of capital invested Constanta and Bucharest are important as are counties from the West and Northwest regions and Neamt County in the Northeast Region mainly deriving from the acquisition of Rifil (textile sector) by an Italian company (figure 6.14).
Figure 6.14: Capital invested by Italian firms.
Source: National Trade Register Office (2006)

Figure 6.15: Location Quotients for Italian FDI.
Source: National Trade Register Office (2006)
Most Italian enterprises are labor-intensive and over half (52.4 percent) of the Italian capital in Romania is invested in manufacturing, with a further 21 percent in construction (Fundatia News 2005; Barleanu 2004). With more than 150,000 jobs created directly and half a million jobs created indirectly, Italian investors maintain an important position in the Romanian economy (Barleanu 2004; Stocchiero n.d.). Most of the Italian enterprises involved in manufacturing work in the outward processing system, which means that their main reason for investing in Romania is to capitalize on cheap labor (Iordache 2005). This system allows companies from the European Union to outsource (partially or wholly) their industrial production and then re-import the final product with partial or total exemption from import duties and taxes. Until a few years ago, the reported wage differential between Italy and Romania was about 17 to 1 (Martin and Straubhaar 2002). The distance between Timisoara and Treviso (a little over 1000 kilometers or 650 miles) or any other city in Northeastern Italy can be covered by trucks in less than a day, which makes factories in Timisoara ideal for just-in-time production. Romania ranks second (after China) in Italy’s importation of clothing and first in the importation of footwear, which illustrates the importance of outward trade processing for Italian companies (Stocchiero n.d.).

Many Italian firms in Romania, especially the ones from the Veneto region, have traditionally operated within “industrial districts”\textsuperscript{110}. This gave them a

\textsuperscript{110} An industrial district in Italy is a geographical cluster of numerous small and medium-sized companies linked horizontally or vertically. Many of these small companies specialize in only one phase of the production process (Berger and Locke 2001). Often an industrial district brings together firms involved in various stages of the production process in a particular industry (Berger and Locke
competitive advantage to compensate for the very small size of most of these enterprises. This institutional embeddedness within the districts had initially impeded the mobility of the small Italian firm, which explains the relatively later internationalization of Italian companies. However, the majority of the Italian small and medium-sized companies operate in the standard technology sector, which is heavily exposed to international competition (Majocchi 2004). Labor costs became more and more important and it was only a matter of time before the first Italian companies decided to move their operations eastward. Because of the tight relationship that exists between firms within an industrial district, the first movers were soon followed by other companies, customers, suppliers and competitors as well as banks and other service firms. The relationship between the leader companies coming from Italy and partner corporations, both Italian and Romanian tend to reproduce the relations that have existed in the Italian industrial district on

2001: 4). This way firms are able to achieve high levels of flexibility and productivity as they can generate economies of scale while staying small. The success of these firms and of the industrial district more generally is a function of the collaboration between and among the component firms. Within the industrial district strong personal relations develop with managers of suppliers, clients and competitors (Majocchi 2004). The district is also anchored in a local “institutional infrastructure” that includes banks and other business services, governmental or non-governmental institutions (like the chamber of commerce and local universities) (Berger and Locke 2001: 6). Firms are also deeply rooted in the local culture, understood as the existence of particular “cultural practices and attributes” within a community shared by all firms (Mariotti 2004; Berger and Locke 2001: 6). Here we could include the existence of craft traditions in a particular trade, as well as shared work and family ethics (Berger and Locke 2001: 6; Spaventa and Monni 2005: 3). We could also point to the existence of a social capital, which “indicates the degree of reciprocal trust, morality and ethics in business, which contributes among other things to the reduction of transaction costs and to the increase of information exchange and reciprocal cooperation” (Spaventa and Monni 2005: 3).

111 For instance, 52.6 % of the firms producing shoes in Montebelluna have moved mainly to Romania and mainly to Timisoara. (Spaventa and Monni 2005). It must also be noted that for 8,782 employees that are working in Montebelluna, in the external belt of subcontracting activities mainly in eastern countries, there are about 60,000 workers. It is in fact striking that last year the local association of entrepreneurs defined Timisoara as the 8th province of the Veneto region (Belussi and Asheim 2003).
an international level (Majocchi 2000: 7). As a result of this process, Spaventa and Monni (2005) argue that an industrial district is already forming in Timisoara.\footnote{Crosetto (2004), on the other hand argues that IDs have not yet materialized in Romania, not even in the Timisoara area. The reason, he argues is that Italian investors are still operating in non-specialized areas where different productions are performed side-by-side. Romanian industrialists, he claims, tend to neglect cooperation building their strategies on fierce competition.}

There is also evidence to show that many Italian firms tend to subcontract, creating a network of firms with Romanian counterparts (Majocchi 2004; Montagnana 2005). Spaventa and Monni (2005) go a step further to argue that the establishment of local firms in Timisoara by companies from the Veneto Region is simply a way of managing the subcontracting process. “These firms establish links with local firms through subcontracting, joint ventures or partnerships, or create new companies through direct investment. As a result local firms gradually grow and acquire know-how while the local workforce acquires specific skills” (Spaventa and Monni 2005b). This results in an important contribution to the diffusion of a culture of entrepreneurship in the region (Majocchi 2004: 9). Spaventa and Monni (2005) are optimistic when they argue that, as the knowledge gap between the Veneto and the Timisoara contractors narrows, and as trust develops between them, more and more stages of production will be transferred or outsourced to firms in Timisoara.

Within manufacturing, Italian investors are mainly involved in five sectors which in order of significance are: garments; machines and equipments; metallurgy; mineral products; and footwear. These five sectors represent 70 percent of all exports made by Italian firms in Romania (Banat Business 2005). More recently, labor-intensive sectors no longer seem to hold the same attraction for Italian
investors. An increasing number of Italian investments are in the technologically more advanced sectors (Iordan et al 2005). More Italian firms are also expected to get involved in the food industry (ibid).

Italians have invested in other economic sectors and more than 14 percent of Italian investments are in agriculture (Mihailescu 2005). Italian investors have purchased large tracts of agricultural land especially in Timis and Arad counties and are the most active foreign investors in agriculture. Many Italian banks have also opened branches in Romania including Banca Italo-Romana, Banca di Roma, Unicredit Romania, San Paolo IMI Romania and Daewoo Bank. Italian firms are also very active in sectors like nuclear energy (Ansaldo Energia) and transport and infrastructure construction (Astaldi/Italstrade, Gavio/Grassetto Costruzioni, Todini Costruzioni Generali). Although the majority of Italian firms are still involved in industrial activities, the general tendency is towards a diversification of investments into other economic sectors.

6.1.6 FDI from the United States

With more than US$830 million invested by September 2006, the US ranks seventh among investing countries in Romania (table 6.1). Almost 5,000 U.S.-owned firms were recorded at the National Trade Register Office, twice as many as from the United Kingdom or the Netherlands but less than one quarter of the number of Italian firms. The average investment is rather small - under US$200,000 per investment - suggesting that besides the well-known multinational corporations

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113 In 2003 alone Italians purchased 200,000 hectares of agricultural land, most of it in Timis and Arad counties (Fundatia News 2005).
many individuals or small firms have invested in the country. It is also the case that most of these U.S. corporations have invested relatively limited amounts. Moreover often the investment in Romania has taken the form of a subsidiary from a third country while reinvested profits have not been counted as FDI (Coman 2006). The U.S. Commercial Service (2005) estimates that U.S. investments in Romania are at least double the official figures recorded by the National Trade Register Office. Most large U.S. corporations entered the Romanian market after 2002, the year when Romania was invited to join NATO. Romania has generally supported American foreign policy, including the war in Iraq, and some analysts see a clear relationship between diplomatic links and increasing American business in Romania (Ispir 2004).

Many American firms have invested in sectors like IT and telecommunications, financial and professional services, manufacturing (especially automotive), consumer products, hospitality and the agriculture and food industry (Pana 2005). The automotive industry has, in the last few years, been one of the most dynamic sectors of the Romanian economy and several U.S. based corporations were attracted by Romania’s potential. Honeywell Garrett, Johnson Controls, Solectron and Delphi Packard have invested in the Romanian automotive sector. American corporations are also involved in the manufacturing of heavy equipment. Timken acquired the Romanian producer of heavy bearings in Ploiesti and invested over US$20 million (Pana 2005). The Ploiesti plant has, as a result,

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114 In the 1990s in particular U.S. corporations preferred to start small and grow organically through the reinvestment of profits.
115 For example companies like Solectron, Timken and Procter & Gamble have reinvested significant percentages of their Romanian profits (Coman 2006).
become one of most important producers of large cylindrical and tapered roller bearings in Europe. Other U.S. companies that have invested in the Romanian manufacturing sector include Precision Castparts Corporation (PCC) which in 1999 acquired Sterom Campina, one of the major oil equipment producers in Romania for $8.3 million and Trinity which owns the majority shares in the rolling stock company Astra Arad (also acquired in 1999) (Pana 2005). GE Aircraft Engines (GEAE) and Turbomecanica SA of Bucharest have also formed a joint venture to manufacture jet engine components (Pana 2005).

The IT and telecommunication sector has also attracted U.S. investment. Microsoft, Dell, Oracle and HP are all present in Romania through their sales operations (Pana 2005) and the startup firm, Blazent is also outsourcing to Romania. The presence of a large pool of educated college graduates may convince other firms to develop similar links. In February 2007, in the presence of Bill Gates, Microsoft Founder and Chairman, Microsoft Romania inaugurated its Global Technical Support Center in Bucharest which will provide advanced technical expertise for some of Microsoft’s worldwide customers. Two important U.S. telecommunication companies are also present: Qualcomm, the California-based corporation is one of the major shareholders of Inquamwhich, in turn, owns Zapp, a Romanian mobile phone operator while a second U.S. company, UPC is one of Romania’s most important telecom (cable TV, phone and internet) providers.

American corporations have also invested in the Romanian agriculture and food industry. Cargill has made several acquisitions to become one of the largest owners of grain storages (Pana 2005). Another U.S. based company, Smithfield

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Foods, has acquired Comtim, a vertically integrated meat processing company in Romania producing 200,000 market hogs annually (www.smithfieldfoods.com). To date the company has invested US$200 million and plans to invest a total of US$800 million in the Romanian meat industry (Ciriperu 2006). Numerous other well-known American corporations are present manufacturing food stuffs (Bunge, Kraft), tobacco products (Philip Morris) and consumer products (Colgate Palmolive and Procter & Gamble) (U.S. Commercial Service 2005).

American brands also dominate the higher-end business hotel sector. Howard Johnson, Marriott, and Hilton are all present in Romania. However, these hotels are not owned by the respective U.S. companies but are franchised operations. U.S.-based franchises are the most popular among Romanian franchisees\(^\text{117}\). McDonald’s, Pizza Hut, KFC, Candy Bouquet, Four Star Pizza, Daylight Donuts, Coca Cola, Pepsi Cola, Ruby Tuesday’s, American Life Insurance Company, Hertz, Budget, Pizza Inn, Gloria Jean’s Café and Computer Troubleshooters are among American franchises present in Romania (U.S. Commercial Services 2005).

Almost half of all U.S. firms are concentrated in the Bucharest region accounting for almost 80 percent of the capital invested (table 6.5; figure 6.16). Four other neighboring counties, Teleorman, Dambovita, Prahova and Giurgiu, have also received substantial US FDI (figure 6.17). Several larger counties have also attracted US FDI, however most of the counties have received insignificant amounts. Figures 6.16 and 6.18 show that, aside from Bucharest, no region seems to

\(^{117}\) More than 21 percent of all franchises in Romania are U.S. based (U.S. Commercial Service 2005).
be particularly favored by U.S. investors. Transylvania has attracted more investors from USA than counties east and south of the Carpathians but when looking at the relative presence of U.S. firms no region stands out beyond Bucharest.

Figure 6.16: U.S. firms in Romania.
Source: National Trade Register Office (2006).
Figure 6.17: Capital invested by U.S. firms.  
Source: National Trade Register Office (2006)

Figure 6.18: Location Quotients for U.S. FDI.  
Source: National Trade Register Office (2006)
6.1.7 Hungarian FDI

Hungary ranks 13th in terms of capital invested in Romania with over US$430 million invested between 1991 and September 2006 (Table 6.1). More than 6,200 investors have started businesses in Romania (ranking fifth overall), but most of these investments are small or very small with an average investment of only US$70,000.

While the major Hungarian companies have generally entered the Romanian market through acquisition of local firms and are generally market-oriented, the CEO of the Hungarian Investment and Trade Development Agency estimates that 30 percent of all Hungarian firms in Romania are engaged in outsourcing (Antaloczy and Elteto 2002; Gumbell 2004). One-third of all Hungarian companies are in the wholesale sector but more than 60 percent of all Hungarian FDI is in retail (table 6.4). Many Hungarian companies are also involved in industry, although the majority of these are also small.

<table>
<thead>
<tr>
<th>Sector</th>
<th>Percent Companies</th>
<th>Percent investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale</td>
<td>31.1</td>
<td>6.0</td>
</tr>
<tr>
<td>Industry</td>
<td>22.9</td>
<td>18.5</td>
</tr>
<tr>
<td>Retail</td>
<td>15.4</td>
<td>60.5</td>
</tr>
<tr>
<td>Service</td>
<td>13.9</td>
<td>10.9</td>
</tr>
<tr>
<td>Agriculture</td>
<td>4.9</td>
<td>0.8</td>
</tr>
<tr>
<td>Tourism</td>
<td>4.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Construction</td>
<td>4.2</td>
<td>2.3</td>
</tr>
<tr>
<td>Transportation and</td>
<td>3.3</td>
<td>0.6</td>
</tr>
<tr>
<td>Communication</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Table 6.4: Sectoral distribution of Hungarian investment in Romania. Source: The Hungarian Investment and Trade Development Agency (2004).
A selection of Hungarian companies operating in Romania are OTP (in the banking sector), MOL (in the fuel retail sector), Dunapack and Cesarom (in manufacturing), Gedeon Richter (pharmaceuticals), Profi Rom (retail) and Salina Invest (hotels).

Among the FDI source countries studied in this chapter, investments from Hungary were the least concentrated in the Bucharest Region. Less than six percent of all Hungarians firms are located in the city of Bucharest or in the surrounding county of Ilfov. However, because these investments are much larger than the average Hungarian investment some 40 percent of all Hungarian FDI is concentrated in the capital and its surrounding region. This is possible because, in many cases, Bucharest serves as the headquarters for Hungarian firms with national coverage.

Hungarian investment demonstrates a remarkable degree of geographic concentration with almost 93 percent of investment destined for Transylvania (figure 6.19). The Northwest Region (42.2 percent) and Central Region (40.8 percent) have each attracted more than 40 percent of all Hungarian firms and the West Region has received ten percent of all Hungarian investment in Romania. Two counties, Bihor and Harghita, stand out in particular with almost 20 percent each of all Hungarian companies. Very few Hungarian firms have ventured outside Transylvania and the Bucharest Region. There are no Hungarian investments in five counties and no other county has more than ten Hungarian firms (figure 6.19).

Location quotients are also highest in seven counties in Transylvania (figure 6.21). In Harghita, where the majority of the population is ethnic Hungarian, half of
all foreign-owned companies are Hungarian in origin\textsuperscript{118}. Indeed, in all seven counties ethnic Hungarians represent a sizeable percentage of the total population. Most of the Hungarian capital invested in Romania also went to the three regions in Transylvania. Bucharest Region and two other counties (Arges and Constanta) have also received significant amounts (figure 6.20).

Figure 6.19: Hungarian firms in Romania. 
Source: National Trade Register Office (2006).

\textsuperscript{118} Hungarians also comprise the majority of the population in the county of Covasna. Here 38.6 percent of foreign investors are Hungarian.
Figure 6.20: Capital invested by Hungarian firms.  
Source: National Trade Register Office (2006)

Figure 6.21: Location Quotients for Hungarian FDI.  
Source: National Trade Register Office (2006)
6.1.8 Greek FDI

Greece is the tenth largest investor in Romania with more than US$650 million invested between 1991 and 2006. However, unofficial statistics credit Greek firms with investments worth more than three billion euros (or almost US$4 billion)\(^{119}\) (Cioacata 2006). There are more than 3,500 companies with Greek capital in Romania but they are very unevenly distributed. Among the investing countries studied, Greek firms are the most heavily concentrated in the Bucharest-Ilfov region. More than 67 percent of all Greek-owned companies are registered in the region of Bucharest and more than 60 percent are in the city itself (table 6.5). No other region, besides Bucharest exhibits a similar draw for Greek firms, although there is a general preference for the Eastern and Southern counties then for Transylvania and Banat (figures 6.22 and 6.24).

Unfortunately data on the distribution of Greek FDI in Romania are not available. However, data on Greek and Turkish FDI combined shows an extreme concentration of FDI in the Bucharest Region (76 percent). The rest of the country has received 24 percent of total Greek and Turkish FDI combined and no one region appears to be especially privileged (figure 6.23).

According to Ioannis Dasopoulos from the Greek Businessmen’s Association in Romania, “Forty six percent of the Greek firms in Romania are joint ventures and some 20 percent of them have set up branch offices, 23 percent a distribution network, 37 percent production units, six percent branch offices and

\(^{119}\) According to Mr. Gassios Pantelis, first-secretary of the Economic and Commercial Office, Embassy of Greece in Bucharest.
distribution networks and 14 percent production units and distribution networks” (Topliceanu 2003). Most investments are in banking, telecommunications, construction and food processing. Alpha Bank started its Romanian operation in 1994 (under the name Banca Bucuresti), as the first foreign bank in Romania (www.alphabank.ro). Since then four other Greek banks have also started operations in Romania: Commercial Bank of Greece (which recently changed its name to Emporiki Bank), Piraeus Bank, National Bank of Greece and Eurobank. National Bank of Greece, the largest bank in Southeast Europe entered the Romanian market through its acquisition of Banca Romaneasca S.A, while Eurobank bought a majority stake in Banc Post S.A.

Another important Greek investor in Romania is OTE (Hellenic Telecommunications Organization), which acquired the formerly state-owned Romanian telecommunications company, Romtelecom, in 1998. Since then, company officials indicate that OTE has invested close to US$1 billion in Romania, including the purchase price for Romtelecom (Topliceanu 2003). Another Greek telecom company, Germanos Telecom Romania is also present in Romania with numerous stores; some of them owned directly by the company while others are franchised (Topliceanu 2003).

Greek firms have also invested significant amounts of capital in the food and tobacco sector among them Delta (dairy products), Loulis Mills Group (milling, baking and pastry), Chipita International (snack foods), Hellenic Bottling Company Groups and Papastratos (tobacco). Delta arrived in Romania in 1994 and started

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120 Delta was bought in 2005 by Nestle’s Greek division. The same year, the new company merged with Chipita International S.A. (http://www.invgr.com/nestle_delta_ice_cream.htm).
production in 1998. After investing more than US$35 million the Greek company has a 43 percent market share for ice cream products (Topliceanu 2003). Another Greek firm, Loulis Mills has been present in the Romanian market since 1997 when it acquired Titan S.A. from Bucharest and Mopan S.A from Targu Mures and in 1999 it built an entirely new production facility, considered one of the most modern milling and baking units in Southeastern and Eastern Europe (Topliceanu 2003).

Hellenic Bottling Company (CCHBC) has bottled Coca Cola in Romania since the early 1990s and also owns Dorna Apemin SA, a natural sparkling mineral water company acquired in 2002. To date the company has invested over US$350 million in Romania (Topliceanu 2003). Alexandrion Group is also an important Greek- Romanian joint venture that has a fine alcoholic drinks factory in Ploiesti (Topliceanu 2003).

Figure 6.22: Greek firms in Romania.
Source: National Trade Register Office (2006).
Figure 6.23: Capital invested by Greek and Turkish firms.  
Source: National Trade Register Office (2006)

| 0.31 | 0.11 | 0.81 | 0.71 | 0.15 | 0.64 | 1.55 |
| 0.36 | 2.74 | 1.53 |
| 0.29 | 0.32 | 0.76 |
| 0.98 | 0.95 | 1.10 |
| 0.99 | 1.22 | 1.68 |
| 2.94 | 3.47 | 2.59 |

Figure 6.24: Location quotients for Greek FDI.  
Source: National Trade Register Office (2006)
6.1.9 Turkish FDI

Turkish investors represent one of the largest business communities in Romania, with over 9,400 companies. Together they have invested more than US$571 million (table 6.1). The average Turkish investments is small (US$60,370), although there are some large Turkish companies and holdings. More than half (56 percent) of all Turkish firms are registered in the Bucharest Region and 46 percent in the city itself (table 6.5). A significant number of Turkish investors are also found in Constanta County which has a sizeable Turkish minority (figure 6.25). Turkish-owned firms are present in all counties and regions but are concentrated in the Southern and Eastern counties. Location quotients are highest in Ilfov, Braila County, Teleorman and Constanta Counties (figure 6.26).

The main sectors of investment for Turkish firms are retail and wholesale, but larger firms are in the banking\textsuperscript{121}, food processing\textsuperscript{122}, electronics\textsuperscript{123}, textile, ball bearings production\textsuperscript{124} and road construction sectors\textsuperscript{125} (The New Anatolian 2006).

\textsuperscript{121} In 2000 Finans Bank (from Turkey) acquired a Romanian-American bank founded in 1993 (The New Anatolian 2006). Today Finans Bank has 60 branches in Romania. Another Turkish bank, Demirbank was bought by Uni Credit (from Italy) in 2002 (www.demirbank.ro). The third Turkish bank in Romania, the Turkish-Romanian Bank went bankrupt in 2002.

\textsuperscript{122} Ulker started a food processing company in Popesti Leordeni, near Bucharest and invested US$23 million (Hotnews 2007). Also in Pascani (Northeast Region) Pakmaya owns the largest yeast producer in Romania supplying two thirds of the Romanian yeast market (The New Anatolian 2006)

\textsuperscript{123} In 2002, local refrigeration company, Arctic Gaesti was acquired for US$18 million by Arcelik (Mihaescu 2004). Today it produces not only refrigerators but also cooking appliances and televisions. The company is the absolute market leader in Romania and exports 65 percent of production (Mihaescu 2004).

\textsuperscript{124} The ball bearing company in Barlad (Northeast Region) was acquired by the Turkish company Kombasan (The New Anatolian 2006).

\textsuperscript{125} Several Turkish companies and consortia are involved in road construction in Romania. Among these Yuksel Makimsan Ener worked on the construction of a segment of the Bucharest-Constanta motorway, a contract worth more than US$80 million (Mihaescu 2004).
Turkish firms are also active in the chemical sector, wood processing and in the production of special steels (Mihaescu 2004; The New Anatolian 2006).

![Map of Romanian provinces showing the number of Turkish firms.]

Figure 6.25: Turkish firms in Romania. Source: National Trade Register Office (2006).

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126 Azomures, the largest producer of chemical fertilizers in Romania was acquired by Transworld Fertilizers in 1998. More than 75 percent of its production is exported (www.azomures.com; Mihaescu 2004).

127 Prolemn in Targu Mures is owned by Hayat Holding (Mihaescu 2004).

128 Erdemir Eregli has acquired Special Steel Works in Targoviste for US$10 million (South Region) (Mihaescu 2004).
Figure 6.26: Location Quotients for Turkish FDI.
Source: National Trade Register Office (2006)

6.2 Conclusion

Romania has attracted investment from more than 130 countries (Voicu 2000) and yet roughly two-thirds (65 percent) of all foreign-owned companies in Romania and more than 83 percent of inward FDI is European in origin. In addition, a significant percentage of foreign companies are East Asian in origin (mainly from China) or from the Middle East although their investment represents less than 4 percent of total FDI. North American investors also have a limited impact on the Romanian economy representing less than four percent of total foreign-owned firms and less than five percent of total FDI.
6.2.1 Average Investment

Average investment amounts tend to be much higher for countries physically and culturally distant from Romania. In the case of countries or territories like the Dutch Antilles, Marshall Islands, the British Virgin Islands, Thailand or New Zealand, distance and lack of information about Romania preclude all but the largest corporations from investing in Romania. The average investment in a company with capital from the Dutch Antilles for example, exceeds $59.3 million (The National Trade Register Office 2006; table 6.1). Large, multinational corporations adapt more easily to new business environments and can also afford to hire consulting companies with experience in the country in which they intend to invest. Moreover they have the capacity and presence to negotiate with both the national government and local authorities for better terms for their investments and often significant incentives. A number of the smaller countries or territories notably the Dutch Antilles, Marshall Islands, British Virgin Islands, Liechtenstein and Gibraltar are also used as offshore financing centers by multinational corporations with their origins elsewhere. Furthermore European countries such as the Netherlands and Austria have generally more favorable tax regimes and many large multinational corporations appear to have invested in Romania through Dutch or Austrian subsidiaries.

On the other hand, for historical and cultural reasons Hungarian, German, Turkish and Greek investors are more familiar with the Romanian market. Therefore, in addition to the large corporate investor, a significant number of individuals from these countries have also started small businesses in Romania.
Consequently average investments from these countries are much lower. In the case of Italian companies the very low average investment is a mirror of the situation in the country of origin where the economy tends to be dominated by small firms sometimes associated in industrial districts.

Even smaller are average investments from China and the Middle East (The National Trade Register Office 2006; table 6.2). Many Chinese entrepreneurs arrived in Romania in the 1990s and opened restaurants and shops which tended to sell cheap items imported from China. The capital needed for such ventures especially in the early 1990s was limited. Entrepreneurs from the Middle East also took advantage of the void that existed in the Romanian market in the early 1990s especially for consumer products. Anecdotal evidence suggests that many of these investors came to Romania as students and remained to open small businesses in the retail trade sector. These Middle Eastern and Chinese companies make up one quarter of all registered companies with foreign capital in Romania but contribute only $483.7 million or less than three percent of the total inward FDI stock (The National Trade Register Office 2006; table 6.1).

### 6.2.2 Mode of investment and sectors of investment

In general foreign firms from the nine countries examined invested across the range of economic sectors. However specialization in certain economic sectors could also be distinguished. For example, most German, Austrian, French and Italian companies are involved in manufacturing. German and French companies dominate the automotive sector while many Italian and German companies are involved in the
production of textiles, garments and footwear. Dutch, Greek, American and Turkish companies have heavily invested in the food industry while Austrian investors have made significant investments in wood processing and furniture as well as the construction materials sectors.

Modern retailing in Romania is dominated by German and French companies and most of the Hungarian capital as well as significant shares of Turkish and Greek capital have also been invested in retail albeit mainly in smaller retail stores. Fewer investors were found in agriculture; most of the foreign-owned agricultural land is Italian but American and Dutch interests have made some of the most important investments in this sector. As a general rule Italian and many German investments are resource-driven, investing predominantly in labor-intensive sectors. Austrian and French firms on the other hand tend to be market-driven. Firms from these countries employ more modern technology and are less affected by rising labor costs.

While German and Austrian companies, as well as the majority of Hungarian firms have preferred greenfield investments, French companies have tended to enter the Romanian market through the acquisition of privatized plants. In the first case greenfield investments are preferred because investors are already familiar with the Romanian market and have sought to avoid the problems associated with state-owned enterprises including obsolete technology and labor-related issues. French investors, on the other hand have generally chosen to enter the Romanian market through the acquisition of existing companies. In doing so they also acquired knowledge of operating in the Romanian market as well as an existing network of
suppliers and customers. For the same reason, Greek investors tend to prefer joint ventures while Germans and Austrians in contrast, prefer 100 percent ownership.

There are additional ways of mitigating the risk of operating in little-known markets. Italian investors, for example, generally start with small companies that coordinate their activities in Romania. They subcontract most phases of production to Romanian or other Italian companies, thereby mimicking the relationships that exist in Italian industrial districts. American companies also generally start small and then grow organically (by reinvesting profits) or through acquisitions as they learn how to operate successfully in the Romanian market.

6.2.3 Geographical Distribution

Foreign investments from the nine countries exhibit quite different geographies. Investments from the Netherlands, Greece, and Turkey are heavily concentrated in the capital city and region whereas German, Hungarian, French and Italian investors have a stronger presence outside Bucharest (table 6.5). Most Hungarian and German investments are concentrated in Transylvania and especially in those counties with sizeable Hungarian and German minorities respectively. Very few Hungarian companies have invested outside Transylvania or Bucharest. Austrian investors have also preferred Transylvania and Bukovina, regions that before 1918 had been part of the Austro-Hungarian Empire.
<table>
<thead>
<tr>
<th>Country of origin</th>
<th>Bucharest</th>
<th>Bucharest region (+ Ilfov county)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Firms</td>
<td>Capital</td>
</tr>
<tr>
<td>Austria</td>
<td>24.1</td>
<td>94.1</td>
</tr>
<tr>
<td>France</td>
<td>39.1</td>
<td>19.5</td>
</tr>
<tr>
<td>Germany</td>
<td>19.9</td>
<td>26.9</td>
</tr>
<tr>
<td>Italy</td>
<td>19.6</td>
<td>32.2</td>
</tr>
<tr>
<td>Netherlands</td>
<td>41.5</td>
<td>57.8</td>
</tr>
<tr>
<td>USA</td>
<td>46.6</td>
<td>69.0</td>
</tr>
<tr>
<td>Hungary</td>
<td>5.5</td>
<td>39.3</td>
</tr>
<tr>
<td>Turkey</td>
<td>45.7</td>
<td>70.0*</td>
</tr>
<tr>
<td>Greece</td>
<td>60.4</td>
<td>70.0*</td>
</tr>
</tbody>
</table>

* Turkish and Greek capital together

Table 6.5: Concentration of foreign firms and FDI in Bucharest City and Bucharest Region
Source: National Trade Register Office (2006)

Italian investments are found in all counties, although a clustering of Italian companies in the West Region, which is closest geographically to Italy, is clearly visible. Outside of the three regions in Transylvania there are fewer Italian investors although in some areas they represent an important percentage of the foreign business community. On the other hand Turkish investors have clearly been attracted to those areas with significant Turkish minority populations such as Constanta County. Turkish investments also represent a higher relative percentage of total foreign investments in the counties east and south of the Carpathians that had been under Ottoman suzerainty before 1878, the year when the Sublime Porte recognized the independence of Romania. The same pattern can be seen in the case of Greek investments with many Greeks arriving in Romania during Ottoman times as merchants or as administrators sent by the Sultan. In these cases historic cultural ties are clearly significant in determining the contemporary distribution of investments.
No obvious distribution patterns could be detected for Dutch or U.S. investments. These countries are clearly situated farther from Romania and lack historically developed relationships with particular regions or counties. This also helps to explain the extreme concentration of firms and capital in Bucharest. The site of investment for companies from these countries is determined by economic opportunities rather than any historical cultural factors. French investments are concentrated in Arges County and a few neighboring counties. This can also be explained in terms of economic opportunities. Particularly the acquisition of Dacia by Renault was followed by a chain of French investments in the automotive sector all clustering in the same area.

6.2.4 Concluding Remarks

This chapter has examined the different geographies of FDI in Romania based on the geographical origins of foreign investors. The study found that foreign investors have generated different patterns of investment. Investors from countries situated at a shorter psychic distance from Romania tend to cluster in areas with which they have cultural and historical ties, whereas investors from countries that have historically been less connected to Romania tend to prefer Bucharest for their investment. Foreign-owned companies in Romania also exhibit characteristics of firms from the investors’ countries of origin where the economic, political, social and cultural environment may be very different from Romania’s. In this respect, the study has shown that there may be a relationship between the investor’s country of origin and the average size of the investment, the mode of investment, the structure
of ownership, and the nature of the activity (preference for a certain economic activity or sector but also understood in terms of labor, capital or technology intensiveness).

We have learned that in Romania inward FDI flows stayed very low until very recently and increased dramatically only after 2003. However, FDI is still very unevenly distributed across the country. Moreover FDI from each country has a different pattern of distribution. Two questions are obvious and will be answered in the next two chapters: 1) What are the main factors that influence FDI flows to a country or an area within the country; and, 2) What is the impact of FDI on local and national economies.
Chapter 7: FDI IN THE ROMANIAN AUTOMOTIVE INDUSTRY

In chapters 7 and 8, I analyze the main factors that influence inward FDI to Romania as well as the main criteria foreign investors consider when choosing the site for their investment. The second major issue that I investigate in chapters 7 and 8 is the impact of FDI on local and national economies focusing especially on the embeddedness of these foreign-owned companies. Data was collected using a self-administered questionnaire sent to a representative sample of foreign investors. Given time and resource constraints I am focusing on only two manufacturing sectors: the automotive sector and the textile, clothing and footwear sector. The results are discussed in chapter 7 (automotive sector) and chapter 8 (the textile, clothing and footwear sector).

7.1 Major Trends in the Global Automotive Industry

The automobile sector continues to be seen as a key manufacturing industry. In many countries it remains “a vital ingredient in national development strategies” and governments struggle to outbid one another in attracting FDI of this type (Dicken 2003: 355). There are several reasons for this. Firstly, automobile assembly plants tend to be large enterprises which ensure that they have a significant impact on the local and national economy. Secondly, the automobile industry uses a large number of components and materials; it is linked to virtually all manufacturing
sectors from steel to textiles\(^{129}\) (Havas 2000b; Dicken 2003; Heneric et al 2005). Third, the just-in-time production model requires suppliers to cluster close to the assembly plant in order to minimize transaction costs (Dicken 2003; Sit and Liu 2000; Worrall et al 2003). Investments in the automobile industry are consequently seen to have important spin-off effects.

Several tendencies are visible in the automotive components sector. Firstly, an increased number of components that were traditionally made in-house are now outsourced to car parts manufacturers (MacNeill and Chanaron 2005). Certain new technologies are increasingly more complex and change frequently or are located in areas in which car manufacturers lack expertise (Dankbaar 2004b). By externalizing the manufacturing of these components to auto parts manufacturers, the costs associated with R & D is shared by a larger number of customers. Secondly, all auto manufacturers have tried to reduce the number of their first-tier suppliers and part of the responsibility for organizing the supply chain has been transferred to these key first-tier suppliers\(^{130}\) (Havas 2000b; Dankbaar 2004b; Busser and Sadoi 2004; Froggatt 1991). It is not unreasonable to assert that “in terms of size and market power, these global suppliers have become comparable to the car manufacturers themselves” (Dankbaar 2004b: 226).

The automotive industry is one of the three sectors (along with electronics and textiles) in which Central and Eastern Europe has developed into a global production location (Radosevic and Rozeik 2005). Today the Eastern European

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\(^{129}\) In Germany, for instance backward linkages with supplier industries provide products worth 1.3 euros for every one euro produced by automobile assembly (Heneric et al 2005: 5).

\(^{130}\) Wells and Rawlinson (1994) argue that, while the number of direct suppliers may have been reduced, the number of sites of suppliers remained more or less the same as, through acquisitions, many suppliers have become multi-locational (and often multinational).
automobile industry is almost entirely owned by foreign companies. This has been the result of a number of factors. On the one hand, the pre-1989 market for domestic vehicles collapsed as outdated Eastern European car manufacturers could simply not compete with western manufacturers. On the other hand, Western companies also had numerous incentives to invest in Eastern Europe: to capture a large market demand while avoiding trade barriers, and to take advantage of low production costs and the substantial investment incentives offered by Eastern European governments (Sadler and Swain 1994; Pavlinek 2006, 2002a and 2002b; Worrall et al. 2003; Kukely and Czira 2005).

The majority of foreign direct investment in the Eastern European automotive sector has originated from the older member countries of the European Union, but some non-European companies have also been attracted by the prospect of using these locations as a base for their European production (Licht et al. 2005). The idea of production transfer or relocation is consequent on the stagnation of automobile markets in the industrialized countries since the early 1990s, while in the emerging countries automobile production has increased significantly (Lung 2000; Kukely and Czira 2005). Furthermore a specialization in small-car production in Central and Eastern Europe has also become evident (Humphrey and Oeter 2000; van Tulder and Ruigrok 1999; Brocard and Darmaillacq 2003).

FDI is not only responsible for restructuring existing assembly plants but has also played an important role in the transformation of the network of indigenous suppliers (Pavlinek 1998; Pavlinek and Smith 1998). Car manufacturers in Eastern Europe are still more integrated than those in Western Europe, but after
privatization some units were sold to suppliers while assemblers concentrated on their core activities (Richet and Bourassa 2000). Many traditional suppliers were forced to follow the lead of western auto-makers and relocate to Eastern Europe. At the same time, domestic suppliers were pressured to restructure in order to deliver quality products (Pavlinek 2002b; Richet and Bourassa 2000). Domestic suppliers that could not keep up with the demands of the foreign-owned assembly plants were either eliminated or downgraded to second or third tier suppliers. Some observers have interpreted this as a destruction of domestic skills and competencies, but Havas (2000: 257) has argued that there was no “viable alternative to the current restructuring and integration process.” Had it not been for significant FDI inflows, the region’s automotive industry would have failed to survive the loss of international market after the dissolution of the Council of Mutual Economic Assistance (CMEA or Comecon) and would not have been capable of meeting the quality demands of Western markets (Worrall et al 2003; also in Vagac 2000).

Another factor that has shaped the geography of the auto supplier network is the policies implemented by many Eastern European countries that specify a minimum percentage of local content (Busser and Sadoi 2004). This has, however, generally failed to translate into an increased participation of domestic local companies in the automakers network. Instead, most of the time automakers have encouraged traditional suppliers to follow them\(^\text{131}\). Another way to bypass local content requirements is to produce engines or other complex parts locally. Engines not only account for a high percentage of the total number of parts used in the final

\(^{131}\) This is, for instance, the case of Fiat Auto Poland which switched from locally owned suppliers to transnational companies (Havas 2000; also in Havas 1997: 218, cited in Humphrey and Oeter 2000: 55).
product but also represent a high percentage of the total value (Busser and Sadoi 2004: 249). This is how many auto manufacturers claim to have 50-60% (or even 80%) local content even though the majority of their suppliers remain located abroad.

7.2 The Romanian Automotive Industry

According to the former president of the Romanian Agency for Foreign Investments (ARIS), Ana Maria Cristina, the automotive sector is one of the most attractive economic sectors in terms of FDI (Lebedencu 2006). The cumulative FDI stock for the Romanian automotive industry stood at US$ 2.75 billion in 2005 and is expected to add more than US$ 550 million annually between 2006 and 2008 (Rif 2006b; Florea 2006). This is clearly limited compared to the US$ 7.5 billion cumulative FDI stock in this sector in Poland and the Czech Republic; however the migration of transnational automotive corporations to Romania has started only recently and the cumulative FDI stock in the automotive sector is expected to increase substantially in the next few years (Bonoiu 2006).

7.2.1 Motor Vehicle Production

Small scale operations and automobile assembly lines have existed in Romania since before WWII, but large scale operations did not begin until the 1950s when three important motor vehicle manufacturers began operations: these were the truck manufacturer, Roman, in 1954, the bus manufacturer, Rocar in 1956 and Aro, the manufacturer of off-road vehicles in 1957 (Automotive Manufacturers and
Importers Association 2006). Two automobile companies started in the 1960s (Dacia) and 1970s (Automobile Craiova). During the communist period these companies thrived as the command economy guaranteed them a certain number of orders every year and the firms were able to export part of their production to the other Comecon countries. In 1989, for instance more than 60 percent of the total passenger vehicle production was exported\(^{132}\) (Automotive Manufacturers and Importers Association 2006). The domestic market was also protected as imports of motor vehicles were rare (Automotive Manufacturers and Importers Association 2006).

After 1990, Romanian auto manufacturers lost the Comecon market and with trade liberalization also suffered on the domestic market from competition with imported vehicles, which were qualitatively superior and offered with attractive financing packages (for commercial vehicles). For many years the government had sustained these enterprises by offering them generous subsidies and placing orders for the state-owned enterprises while simultaneously searching for strategic investors to buy and restructure them. These measures however only prolonged their agony. In 2005 Rocar finally declared bankruptcy which was followed in 2006 by Aro. The future prospects for Roman are generally seen as poor. Today the Romanian motor vehicle industry is dominated by two foreign-owned carmakers: Renault-owned Dacia and Automobile Craiova, formerly owned by Daewoo.

\(^{132}\) The same year, Aro exported 90 percent of its production.
Dacia

Dacia started in the 1960s as a joint venture with Renault. The first Romanian made car left the factory in 1968 produced under Renault license. However in 1978 Renault withdrew from the joint venture\textsuperscript{133} and Dacia was left to continue alone. After 1990 Dacia sought a new foreign partner. It negotiated a potential acquisition with eight companies including Renault (1990), Peugeot (1993), Fiat, Audi, Chrysler and Hyundai. All failed because, according to Constantin Stroe, general manager of Dacia during the 1990s, these companies were not interested in keeping the Dacia brand and sought the elimination of 20,000 jobs virtually overnight (Evenimentul Zilei 2006). Conversely negotiations with Renault in 1999 ended successfully because Renault was willing to keep the Dacia brand and had a viable strategy for the labor issue. The labor force was eventually reduced from 27,560 in 1999 to 12,650 at present, but this has happened slowly over time and mostly through natural wastage thereby avoiding any significant conflict with the local community (Interview with Mr. Constantin Stroe, vice-president at Dacia 2006).

Several thousand workers retired during this seven-year period while others left voluntarily in part because of the faster pace imposed by Renault. Others were absorbed by suppliers following Renault to Pitesti-Mioveni (Evenimentul Zilei 2006).

Dacia is a market leader in Romania, accounting for some 40 percent of market share (The Economist 2005). After acquisition, Renault invested US $800 million to modernize the Dacia factory. This modernization did not include the acquisition of robots and other automated features because the French auto

\textsuperscript{133} According to the company website, www.dacia.ro.
manufacturer sought to benefit from cheap Romanian labor (Tiusanen 2006). Dacia has increased its production from 70,000 units in 2003 to 95,000 in 2004, and almost 200,000 units in 2006 due mainly to success of the Logan model\textsuperscript{134} (The Economist 2005; www.dacia.ro; George 2006; Margarit 2007). Dacia exported 88,931 cars in 2006 (more than three times the 2004 figure) mainly to Western Europe but also to Eastern Europe, the Middle East, Africa and South America\textsuperscript{135} (Popescu 2006; Margarit 2007; The Economist 2005, George 2006; Ziarul Financiar 2006). Renault has also opened assembly plants for Dacia Logan in Colombia, Russia and Morocco based on CKD\textsuperscript{136} kits from the Romanian plant. Two other assembly plants are scheduled to open in India and Iran and there are also preparations for Brazil and perhaps China. Stroe (2005) estimated that soon the Dacia plant in Romania will produce 700,000 CKD kits annually for assembly plants worldwide. Further investments designed to raise production capacity to 350,000 units per year are, however, on hold because Dacia executives believe Romania will be flooded with imports of used cars after accession, as has happened in the case of Poland despite a new fiscal code drafted to prevent this (Bonoiu 2006c).

\textsuperscript{134} Logan is the “six thousand euro car” designed for the markets of less developed countries but has witnessed an unexpected success even on the Western European markets. The Logan model is based on the B platform which is also used by Renault Clio, Renault Modus as well as Nissan Micra and borrows many other parts from several Renault and Nissan models while at the same time using fewer and less costly parts.

\textsuperscript{135} Presently Dacia exports to over 50 countries.

\textsuperscript{136} Completely Knocked Down, in auto jargon meaning that cars are shipped as kits and assembled outside of the country.
Automobile Craiova/Daewoo

The story of Automobile Craiova begins in 1977 when the Romanian government contacted Citroen to establish a joint venture\textsuperscript{137} to manufacture a certain model of Citroen\textsuperscript{138} renamed Oltcit\textsuperscript{139}. Production started in 1981 and had its ups and downs over the years but in 1991 Citroen decided to pull out of the joint venture. Production did not stop, however and the car was renamed Oltena. However, by then the model was seriously outdated and the government was keenly seeking a new western partner.

At the beginning of the 1990s Daewoo was looking to expand globally and emerging markets in Eastern Europe looked attractive. The region had a tradition in car manufacturing, which guaranteed available qualified labor. In addition, there were a range of underutilized production facilities. Moreover domestic producers enjoyed a virtual monopoly given high tariffs for imported cars. The countries of the region also showed significant potential for development and companies like Daewoo could establish first-mover advantages. Furthermore, until the countries were ready to absorb most of the production, the facilities could be used as export bases for Western Europe.

Daewoo acquired the majority of Automobile Craiova’s shares in 1994 pledging to invest more than US $800 million (Worrall et al 2003) for which it received a seven-year duty free import package and a five-year corporate tax exemption worth, according to some commentators, a roughly equivalent amount

\textsuperscript{137} The Romanian government participated with 64 percent to the joint venture and Citroen with 36 percent (http://www.geocities.com/MotorCity/Downs/4582/oltcit.htm).
\textsuperscript{138} In the 1980s, for a short period of time, the model was also sold in Europe as Citroen Axel.
\textsuperscript{139} The name comes from joining the name of the region (Oltenia) and Citroen.
(Gandul 2006b). The factory in Craiova was, until recently, a joint-venture between Daewoo Korea (51%), and the Romanian government in conjunction with a range of private Romanian firms (49%). The Craiova plant has the capacity to produce annually 100,000\textsuperscript{140} cars, 150,000 engines and 200,000 gearboxes (Datta 2007).

Problems for Daewoo Automobile Romania started in 1998 when Daewoo Korea declared bankruptcy and General Motors, which took over Daewoo in 2002, appeared uninterested in the Romanian plant. GM allowed the Craiova factory to assemble Daewoo cars until October 2005 and to sell them until October 2006 (Bonoiu 2006b). Daewoo/GM’s initial lack of interest in retaining the Craiova plant is somewhat surprising considering that the operation is profitable and increasing sales and turnover year on year (Trefas 2005). In 2006 Daewoo Automobile Craiova sold 23,186 cars representing 13 percent more than in 2005; the plant also manufactured and sold (mainly abroad) 140,000 engines (a 2.5-fold rise from 2005) and 190,000 gearboxes, 60 percent more than the previous year. Indeed engines and gearboxes production has almost reached the plant’s maximum capacity. An important component of revenue is derived from the manufacture of car parts, mainly for export (Autobrief 2007).

In September 2006 the Romanian government announced that it bought the Daewoo’s shares for US$ 60 million and in October initiated new privatization procedures (Ziarul Financiar 2006f). Several auto-makers have expressed some

\textsuperscript{140} Production at Craiova has never reached its full capacity (Automotive Manufacturers and Importers Association 2006).
interest in the factory with Ford and, ironically, General Motors seeming to be the most serious potential investors\(^{141}\) (Bursa 2006; Hotnews 2006 and 2006b).

**Aro/Cross Lander**

The third Romanian carmaker, Aro\(^{142}\), in Campulung Muscel (South Region) began production in 1957 and is the oldest car manufacturer in Romania\(^{143}\). The first model was actually an improved model of the Soviet off-road vehicles GAZ-67 and GAZ-MM\(^{144}\). Over the years Aro has developed many original models of SUVs and light commercial vehicles and by the end of the 1970s it became the largest off-road vehicle manufacturer in Eastern Europe\(^{145}\). The cars were exported to a variety of countries in Europe (including Western Europe), Latin America, Asia (especially People’s Republic of China) and some models were also assembled in Portugal (under the name Portaro), Spain (using the Hisparo brand) and Brazil\(^{146}\). In the 1990s, due to very low capitalization, the company failed to develop new models or to substantially improve existing models and it gradually fell behind its competitors.

In order to save the company, the government decided in 2003 to sell Aro to a little-known U.S. company for a mere $130,000. The new owner renamed the car Cross Lander and planned to sell the vehicle to the U.S. market. It also pledged to invest $3 million in revamping the company and pay off its $11.4 million in debt. Not only has this failed to happen but Cross Lander sold its Tools and Moulds division for

\(^{141}\) Other car makers that have shown interest in the Craiova plant are Renault/Nissan, Chery Auto (China) and more recently Tata from India (Automobile; Trefas 2005; Datta 2007)

\(^{142}\) Aro stands for Automobil Romanesc meaning Romanian automobile.

\(^{143}\) Information from [www.aro.ro](http://www.aro.ro).

\(^{144}\) From [www.craiova.com](http://www.craiova.com).

\(^{145}\) Ibidem.

\(^{146}\) Ibidem.
$5.1 million (Budescu 2005). In 2004, the company sold only a few hundred cars and in 2006 the company declared bankruptcy\textsuperscript{147} (Adevarul 2005; Simion and Topala 2006).

### 7.2.2 Car Parts Industry

Despite the bankruptcies noted above, the Romanian automotive industry has proven to be one of the most profitable business sectors and this has stimulated the interest of foreign investors. Two groups of car parts manufacturers can be distinguished (Automotive Manufacturers and Importers Association 2006):

1. Romanian-owned car parts manufacturers that before 1989 had been the traditional suppliers of the Romanian motor vehicle manufacturers. These companies were privatized to Romanian investors, including some insiders and yet the firms lacked the capital to rejuvenate the plants and to invest in R & D. Consequently most of these companies use old, outdated technology to manufacture low-quality products. When the automobile manufacturers were sold to foreign investors, many Romanian-owned suppliers could not meet the high quality and quantity standards for parts requested by the new owners. As a result, some plants were forced to close while others were relegated to second or third tier suppliers manufacturing low or medium-tech products. Factories were also partially converted and today their automotive production often represents only a fraction of their turnover\textsuperscript{148} (Automotive Manufacturers and Importers Association 2006).

\textsuperscript{147} Recent attempts by a group of Romanian businessmen to take over and resuscitate the company have failed and the assets will be sold to the highest bidders (Stoica 2006; Romanian Daily 2006).

\textsuperscript{148} In 2005, the combined turnover of these companies was 622.9 million euro of which 275.8 million euro was derived from automotive production (Automotive Manufacturers and Importers Association...
2. Foreign-owned companies. Most of these plants started as greenfield investments but the group also includes a few recently acquired state-owned or privately-owned Romanian companies as well as some joint ventures. These plants tend to be equipped with the latest technologies and are producing for export and for the foreign-owned Romanian automotive companies (Automotive Manufacturers and Importers Association 2006). Several dozens of European, American and Japanese companies have started production in Romania, making auto parts for a large selection of foreign and domestic carmakers. Many other companies are in the process of relocating to Romania from the European Union and even from other countries in Central Europe pushed by their rising labor costs after accession to the European Union (The Economist 2005; Evenimentul Zilei 2004; Bonoiu 2005; Ciriperu and David 2005; Bonoiu 2004; Rif 2006b; Bulzan 2006).

The Romanian automotive industry produced US$ 2.5 billion worth or products in 2005 and turnover is estimated to increase up to three-fold by 2008 (Bonoiu 2006) to reach US$ 11-15 billion in 2010 (Laurentiu 2006). Romania has attracted seven new FDI projects in the automotive industry in 2005, the same number as France, and one more than Hungary, the country that was once the favored destination for FDI. The most popular countries for automotive FDI projects in 2005 were the Czech Republic (20), Slovakia (18) and Poland (17) (Bobocea 2006). These three countries together with Hungary, Slovenia and Western Romania form a transnational automotive cluster called by some “Detroit East” (Edmondson et al 2005; Bonoiu 2006). Several new projects were launched in 2006 and an even

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From the 36,500 total people employed by these companies approximately 16,000 were still involved in automotive production (ibidem).
greater number of projects scheduled to open in 2007 or 2008 are at different stages of development, from planning to construction (see appendix A and figures 7.1 and 7.2). Besides the new companies, existing firms have increased turnover several times in the last three or four years (Rif 2006b; Popescu 2006b). Exports from this sector have reached US$420 million in 2005, an increase of 81% over 2004 (Ziarul Financiar 2006). Numerous jobs have been created especially in Western Romania. In 2005 alone, 25,000\textsuperscript{149} jobs were created in the automotive industry (Rif and Ciriperu 2006).

\textsuperscript{149} This number is the subject of some dispute. Central Europe Trust Company (2006) noted 12,400 new jobs created in the automotive industry in 2005. At the end of 2004 the number of employees in the foreign-owned automotive component industry was 52,459, 42% more than at the end of 2003 and more than 72.5% more than at the end of 2002 (Central Europe Trust Company 2006b). Based on these figures the claim of 25,000 new jobs in 2005 can be seen as a reasonable one.
Figure 7.1: Foreign-owned automotive plants in Romania.
Figure 7.2: Foreign-owned automotive plants in construction or in project.
7.3 Research Methodology

A number of complementary methods were used to generate data on the automotive sector. Substantial secondary data was acquired analyzing the content of numerous newspapers from Romania and abroad as well as company and industry websites. Several interviews and a questionnaire provided the main sources for the acquisition of primary data. Interviews are with managers in two automotive companies, the president of the Association of Romanian Automobile Manufacturers (ACAROM) and with officials in two Romanian cities. In addition, a questionnaire was mailed to 51 foreign corporations owning a total of 66 plants in Romania. Due to a low initial response rate, where possible, companies were also contacted via e-mail. Ten responses were eventually received representing a response rate of almost 20%. Several reasons can be identified for the low response rate. Two questionnaires were returned for wrong or incomplete addresses. A third Romanian automotive company returned the questionnaire blank because the joint venture with a Spanish corporation announced in the media had never actually materialized. In the majority of cases the refusal to participate in the survey could be explained by the fact that many of the plants were still under construction or had been operational for only a short period at the time of contact. If we eliminate new projects and consider only those projects operational for at least two years than the response rate is more reasonable (about 30 percent).

Of the ten companies, five are from Germany and one from each the following: France, Italy, Spain and USA while one respondent declined to answer the question about the nationality of its parent company. Most of these companies
are decidedly multinational with branches in more than ten countries from all continents and regions (tables 7.1 and 7.2).

<table>
<thead>
<tr>
<th>Company</th>
<th>No. of countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company 1</td>
<td>12</td>
</tr>
<tr>
<td>Company 2</td>
<td>10</td>
</tr>
<tr>
<td>Company 3</td>
<td>22</td>
</tr>
<tr>
<td>Company 4</td>
<td>9</td>
</tr>
<tr>
<td>Company 5</td>
<td>10+</td>
</tr>
<tr>
<td>Company 6</td>
<td>3</td>
</tr>
<tr>
<td>Company 7</td>
<td>10</td>
</tr>
<tr>
<td>Company 8</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 7.1: Number of countries in which parent company has affiliates or operations (total number of companies that answered this question = 8)

<table>
<thead>
<tr>
<th>Region</th>
<th>No. of surveyed companies with operations in this region</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western Europe</td>
<td>7</td>
</tr>
<tr>
<td>North America</td>
<td>5</td>
</tr>
<tr>
<td>Latin America</td>
<td>6</td>
</tr>
<tr>
<td>East Asia</td>
<td>6</td>
</tr>
<tr>
<td>Other parts of Asia</td>
<td>2</td>
</tr>
<tr>
<td>Africa</td>
<td>2</td>
</tr>
<tr>
<td>Australia and Oceania</td>
<td>1</td>
</tr>
</tbody>
</table>

Table 7.2: World regions in which the parent company has operations

<table>
<thead>
<tr>
<th>Country</th>
<th>No. of surveyed companies with operations in these countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Poland</td>
<td>3</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>3</td>
</tr>
<tr>
<td>Hungary</td>
<td>2</td>
</tr>
<tr>
<td>Unnamed country in Central Europe</td>
<td>3</td>
</tr>
<tr>
<td>(Poland, Czech Republic, Slovakia,</td>
<td></td>
</tr>
<tr>
<td>Hungary and Slovenia)</td>
<td></td>
</tr>
<tr>
<td>Other countries in Eastern Europe</td>
<td>0</td>
</tr>
</tbody>
</table>

Table 7.3: Other countries in Central and Eastern Europe in which the parent company has operations
Several of the companies are also present in other locations in Eastern Europe (table 7.3). The earliest presence in Romania among the ten dates to 1993 but the majority (7) of the surveyed companies arrived in Romania after 2000\textsuperscript{150}. Greenfield investments were the choice of entry in the majority of cases with only three operations starting as joint ventures. As of August 2006 two remained joint ventures, one of which was majority owned by the foreign company (90 percent) while in the second case the foreign company had a minority (20 percent) stake.

The surveyed companies have between 154 and 15,000 employees in one to five sites in Romania and average 2,350 employees. In general these companies have started as relatively small operations and added more employees as their activities have developed. Most respondents were satisfied with their Romanian operations and projected a significant increase in employment in the next two years due to increasing projects and orders, expanding production capacity and an increase in the range of products made in Romania. A few (2) mentioned competition for skilled labor and economic recession as possible causes for stagnation in the number of their employees. Together these ten companies have invested $232 million in Romania and the average investment is USD 29 million.

As noted in Chapter 4 the survey asked questions about the reasons as to why these companies had invested in Romania and about the main criteria they used to select the site of their investment. In order to assess the impact of foreign

\begin{tabular}{|c|c|c|}
\hline
Period & Number of companies & Percentage \\
\hline
Before 1996 & 1 & 10.0 \\
1996-2000 & 2 & 20.0 \\
2001-2003 & 4 & 40.0 \\
2004-2005 & 3 & 30.0 \\
\hline
\end{tabular}
automotive corporations on local communities and economies, the survey also asked questions about the network of suppliers and customers and about their degree of involvement in the local community. Some questions were close-ended where respondents were asked to select all answers that applied or to rank the importance of the given choices. Other answers were left open-ended with no categorization was imposed on the respondents. Given this and the small number of responses, a quantitative analysis was not feasible. Instead a descriptive qualitative analysis was employed. Additionally in-depth interviews with the vice-president of Dacia and with the manager of an automotive joint venture were conducted. In the last five years the Romanian media has published numerous articles on the automotive industry including interviews with several executives. All these media sources were analyzed for content and where appropriate they are used to complement the survey results.

7.4 Determinants

The survey results indicate that the most important reason why foreign automotive companies are investing to Romania is one of lower operating costs and especially lower labor costs (table 7.4)\(^{151}\). Also important is the availability of skilled labor\(^{152}\). Arguably this is a rather tenuous advantage. Already shortages of qualified labor\(^{152}\).

\(^{151}\) For comparison, cost of labor (in euros per hour) in a few selected countries in Europe is as follows: Romania 2, Slovakia 4, Poland 6, Czech Republic 8.5, Hungary 8, Slovenia 8, Portugal 10, Spain 18, France 22 and Germany 32 (Banii Nostri 2005).

\(^{152}\) Many other sources cite the existence and low cost of qualified labor as well as Romania’s position, bordering, or after January 1, 2007 within the European Union as the main factors for the high FDI flows in the automotive industry (Lang 2004; Pahoncia and Rif 2005; Popescu 2006d; Rif and Laurentiu 2005; Cerchez and Anton 2005; Ciriperu and David 2005; Economistul 2006b; Rif and Ciriperu 2005; Bonoiu2004b; Serban 2004; Iovitu and Nedelcu 2001; Rif 2006b, Bonoiu and Marin 2005; Bulzan 2006b).

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workers are appearing, especially in Western Romania, with the consequence of rising wages. As one EU commissioner stated at the end of 2005: “Romania cannot compete only on being a cheap country” (Central Europe Trust Company 2006b: 241).

<table>
<thead>
<tr>
<th>Factor</th>
<th>Average Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low operating costs</td>
<td>3.67</td>
</tr>
<tr>
<td>Low labor costs</td>
<td>3.67</td>
</tr>
<tr>
<td>Skilled labor</td>
<td>3.11</td>
</tr>
<tr>
<td>Proximity to EU</td>
<td>2.89</td>
</tr>
<tr>
<td>Proximity to other countries in Eastern Europe</td>
<td>2.22</td>
</tr>
<tr>
<td>Political stability</td>
<td>1.89</td>
</tr>
<tr>
<td>Market size (population)</td>
<td>1.78</td>
</tr>
<tr>
<td>Market potential</td>
<td>1.78</td>
</tr>
<tr>
<td>Proximity to partner, supplier or customer, already in Romania</td>
<td>1.67</td>
</tr>
<tr>
<td>Romanian government investment policies and incentives</td>
<td>1.67</td>
</tr>
<tr>
<td>Raw materials</td>
<td>1.44</td>
</tr>
<tr>
<td>Other cultural affinities: language, religion, etc.</td>
<td>1.44</td>
</tr>
<tr>
<td>Market strength (spending power)</td>
<td>1.34</td>
</tr>
<tr>
<td>Proximity to Russia and other former Soviet Union republics</td>
<td>1.11</td>
</tr>
<tr>
<td>Owner, CEO or other executive is of Romanian decent or has family in Romania</td>
<td>1.00</td>
</tr>
<tr>
<td>Other (please describe below)</td>
<td></td>
</tr>
</tbody>
</table>

Table 7.4: Determinants of FDI- automotive industry.

The scores for other factors also lend support to the idea that most foreign automotive companies that have invested in Romania are efficiency-seeking rather than market-seeking. Low scores for market size, strength and potential indicate that investors in this sector are not interested in the domestic market. The results also indicate that these automotive companies are westward oriented, with proximity to the European Union considered far more important than proximity to the former
Soviet Union. Proximity to other Central and Eastern European countries is however, of some significance perhaps because Western auto companies have invested heavily in the region and trade relationships have developed between foreign automotive companies in Romania and those in other Central or Eastern European countries.

This might explain why the most important criterion for selecting the site of investment was proximity to markets/customers beyond Romania while linkages with Romanian companies or with suppliers, customers and competitors already present in the area list as less significant (table 7.5). Another factor that foreign companies consider important is the presence of good transportation/communication links. Since transportation infrastructure leaves much to be desired in most regions of Romania, this factor helps to explain the preference of foreign companies for the West or Northwest regions, which are relatively well served by transportation infrastructures (Figures 7.1 and 7.2).

<table>
<thead>
<tr>
<th>Factor</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Proximity to markets/customers beyond Romania</td>
<td>2.90</td>
</tr>
<tr>
<td>Communication/transport links</td>
<td>2.80</td>
</tr>
<tr>
<td>Local authorities’ positive attitude to foreign investment</td>
<td>2.70</td>
</tr>
<tr>
<td>Proximity to major markets</td>
<td>2.50</td>
</tr>
<tr>
<td>Quality of life (cultural amenities)</td>
<td>2.50</td>
</tr>
<tr>
<td>Land availability</td>
<td>2.40</td>
</tr>
<tr>
<td>Cultural similarities to the country and region of origin</td>
<td>2.30</td>
</tr>
<tr>
<td>(language, religion, work ethic etc)</td>
<td></td>
</tr>
<tr>
<td>Local authority incentives</td>
<td>2.00</td>
</tr>
<tr>
<td>Existing linkages with (a) Romanian company or companies in the region</td>
<td>1.70</td>
</tr>
<tr>
<td>Suppliers, customers or competitors have located here previously</td>
<td>1.60</td>
</tr>
</tbody>
</table>

Table 7.5: Site selection determinants- automotive industry
The attitude of local authorities also appears to be important in the process of site selection. Since foreign companies commonly lack information about local areas it is important for them to deal with welcoming and helpful officials not least because the majority of the surveyed companies have entered the Romanian market through a greenfield investment. The availability of suitable land is thus a key concern. While few local councils have land available for investment they are likely to have access to information that will help investors identify suitable privately-owned holdings. Similarly local authorities are aware of underutilized production capacity in existing factories that could be leased to foreign investors (interviews with Mr. Cosmin Coman, PR, Iasi City Hall, and Mr. Gheorghe Falca, Mayor, City of Arad). Maintaining good relationship with local authorities is also important in dealing with regulatory matters.

Half of the surveyed companies considered cultural similarities as important or very important in the choice of their particular site. This is especially interesting given that the same factor was considered unimportant in selecting the country of investment. Several respondents, for example indicated Timisoara as their first or second choice for investment. This city has a pro-foreign investment mayor and council, offers a good quality of life for expatriates and already boasts a large and growing expatriate community.
7.4.1 Hindrances

A number of problems confront foreign investors in Romania. Respondents unanimously identified the difficulties posed by frequent changes of legislation which render long time planning problematic. Cumbersome bureaucracy and corruption are further difficulties noted by the majority of the surveyed firms. Learning the rules and regulations governing operations is especially difficult for the firms that invested through a greenfield investment and that lack a Romanian partner. According to one respondent, all these drawbacks have generated negative press for Romania as a potential investment destination, although there is some evidence that this is beginning to change.

Another constraint on automotive inward FDI, noted by several respondents, is the shortage or absence of qualified labor coupled with low labor mobility. This situation holds mainly in the West Region which has received significant foreign and domestic investment. Here the unemployment rate is low and workers are bussed daily from proximate and more distant areas. On the other hand, the predominantly rural areas in the Northeast and Southwest have much higher rates of unemployment. Yet migration from one region to another within Romania in search of employment remains limited. Evidence suggests that Romanians moving in search of jobs prefer international migration given the significant wage differentials between Romania and the major destinations.
7.5 How Embedded Are These Foreign-Owned Automotive Plants in Romania?

Studies on Eastern Europe are ambivalent about the extent to which foreign automakers are embedded in the local economy. While the Volkswagen-Skoda joint venture in the Czech Republic shows a high degree of embeddedness, Volkswagen Bratislava in Slovakia displays only limited local sub-contracting effects (Pavlinek 1998; Ferencikova and Smith 1997). Pavlinek (Pavlinek 1998; Pavlinek and Smith 1998) argues that the different position of these two plants reflect the varied traditions of automobile production in the two countries. The Skoda plant has a long history in the automobile manufacturing sector and over time has developed a highly efficient supply network. After being acquired by Volkswagen, the company relied on this existing network, which offered the locational advantages of low cost and skilled labor, in preference to sourcing from Volkswagen’s traditional suppliers\textsuperscript{153}. It encouraged its component suppliers to form joint ventures with Western companies and pressured them to restructure (Pavlinek 2003; Richet and Bourassa 2000; Havas 2000; also in Havas 1997, cited in Humphrey and Oeter 2000). As a consequence, 70\% of Skoda’s components and 60\% of materials are supplied by Czech-located producers (Pavlinek 2003; Pavlinek and Smith 1998). Slovakia, on the other hand, lacks the same tradition of automobile production. About 85\% of components for cars produced in the Bratislava plant are supplied directly from Germany (Pavlinek and Smith 1998).

\textsuperscript{153} It also helped that the agreement between the Czech government and Volkswagen required the German automaker to use the traditional Skoda suppliers for a number years. This grace period allowed Czech suppliers to restructure in order to achieve the quality and delivery standards required by Volkswagen (Pavlinek 2003).
Van Tulder and Ruigrok (1998 and 1999) distinguished several types of automotive companies based on the logic of their investment in Central and Eastern Europe. “Frontrunner” companies are firms that have acquired production capacity in order to conquer new markets but also to take advantage of the lower labor costs in order to manufacture cars destined for export to Western Europe (examples are Volkswagen in Czech Republic and Fiat in Poland). “Follower networks” refers to firms only interested in local markets. Such firms are less concerned with meeting local content requirements (for example Ford’s and PSA’s SKD operations). A third type - “peripheral networks” - is best represented by Suzuki’s investment in Hungary and Daewoo’s investment in Poland, Romania and the Ukraine. These companies lacked an established supplier structure in Europe. At the same time, their objective is to use production capacities in Eastern Europe to serve European Union markets and in order to achieve this goal such firms have been required to meet 80% local content requirements (see also Hyun 2003). It follows that these firms are more inclined to source locally (see also Pavlinek 2006). Finally, the “lockout networks” represent the fourth category. Luxury car manufacturers like Audi and Mercedes-Benz have outsourced part of their production to low wage Central European countries like Hungary. Their goal is to re-export production to their home base while working with a selection of their own suppliers that have relocated to Hungary. Van Tulder and Ruigrok (1999) argue that companies most inclined to use local suppliers are peripheral firms, whereas the follower firms are the least inclined to work with local firms. Lock-out companies may decide to invest in local car parts manufacturers and at times these sums are significant. According
to Van Tulder and Ruigrok (1999) frontrunner companies always promise, high levels of local content, while in practice local linkages are often modest.

In the case of Romania, the survey revealed that, in general, material supplies are sourced from the European Union and especially from the home countries of each of the companies included in the survey. Nine of the ten companies are headquartered in the European Union and only a small percentage of material inputs are sourced from Romania, much less from the local economies in which the plants are located. This finding is generally in line with other results (for instance, Licht et al 2005). In certain cases, even material supplies sourced from companies in Romania are supplied by foreign-owned firms following their main client (Ziarul Financiar 2005b; Rif 2006). This suggests an important difference between local content and domestic content. It appears that the main reasons why foreign automotive companies are avoiding local or Romanian companies for their material supplies is because even when these inputs are available from the local economy (which is rare) they are generally of inadequate quality and at times more expensive than imported alternatives. A second reason is that local branches of these multinational corporations have very little independence when it comes to decisions about purchasing material supplies. Most decisions at local branches are taken at the headquarters of these multinational companies. For instance, all decisions regarding sales promotion activities, market territory served by the plant, approval for major capital investments, setting product price level or product packaging design/styling are taken by the headquarter or the parent company. Also the purchasing of materials/components, purchasing production machinery and
recruitment of senior personnel rests very much on the headquarters although in a few cases such decisions may be taken at local level and approved by the headquarters. Plant managers have the power of decision limited to organizing the work flows, training the staff and awarding contracts for services. This explains why most services are contracted with the local economy. Other decisions like selection of subcontractors, material stock levels and raising short term finance are generally taken at local levels but must be approved by the headquarters.

The purchasing of materials is commonly the responsibility of the head office and therefore outsourced globally rather than locally. Materials are then used in common by the group. In one particular case the main client specified the supplies.

Dacia has 188 suppliers\(^\text{154}\) of which 134 are external suppliers while 54 are located in Romania (14 are established in the same industrial park) (www.daciagroup.com). The majority of the Romanian suppliers are foreign companies that followed their customer. In fact only eight percent of the parts used for the assembly of Dacia vehicles are manufactured by firms that depend upon Romanian rather than foreign capital (Central Europe Trust Company 2006). Whereas Skoda-Volkswagen has helped its suppliers to restructure and encouraged them to form joint ventures with western companies, most of Renault’s traditional suppliers in Romania are greenfield investments rather than joint ventures with Dacia’s traditional suppliers.

\(^{154}\) Dacia executives have very recently declared that the Romanian automaker will relinquish some suppliers to produce more components in-house (Marincea 2006).
The Romanian government offered Renault a generous incentive package to acquire Dacia and to source locally. Among these incentives are a five-year exemption from tax on profits, customs duties and VAT on imported inputs and technology as well as VAT on capital goods sourced locally (Larive Romania 2006). Dacia executives have since declared that they want to reduce imports and place greater emphasis on the development of a suppliers’ network in Romania. Accordingly the share of Dacia Logan components sourced from Romania will increase from the current 60% to 80% in 2008 (Dacia 2006). Renault, the parent company, also prides itself on its dedication to sustainable development (Renault 2006). One of Renault’s declared objectives is to include as many local suppliers as possible for its Romanian projects. To date Dacia Logan, Renault has 13 Romanian suppliers, representing less than 7% of the total number of suppliers and 24% of the total number of suppliers based in Romania (Renault 2006). Furthermore Renault is especially interested in local companies that could become suppliers for the entire Renault-Nissan-Dacia group and not simply for the Romanian Dacia plant.

Automobile Craiova has a very limited supplier network in Romania. Although most of the components are imported from Korea, the company has managed to maintain the required local content by manufacturing some of the more complex parts, including the engine and the gearbox, in-house.

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155 Again this figure refers to local content rather than domestic content.
156 This is not unusual, however. After Daimler-Chrysler formed an alliance with Mitsubishi, they sought to rebuild their supplier network by using in common the most competitive suppliers from each auto manufacturer’s network. For instance, the suppliers of Mitsubishi were also given the chance to supply Daimler-Chrysler assembly plants and vice versa with the most competitive retained to supply the allied auto manufacturers (Busser and Sadoi 2004: 249).
Approximately 90% of all production of foreign-owned automotive plants in Romania is exported to the European Union (Rif and Ciriperu 2005). Only four of the ten surveyed companies indicated that they were also selling to companies in Romania although the proportion varied widely from 2 to 95% of total production. In general, automotive companies in the South (and in particular those located around the town of Pitesti) are among Renault-Dacia’s traditional suppliers and sell mainly to Dacia, but an important percentage of their production is now exported to other factories in the group. Autoliv opened its Pitesti plant to supply components for the two Romanian car manufacturers, Dacia and Daewoo. Later with the opening of two other manufacturing facilities in Brasov (in the Center Region), Autoliv started producing for the Western European markets (Prime Zone 2005; Iovitu and Nedelcu 2001).

Automotive companies that cluster in Western Romania have tended to produce almost exclusively for export (Ciriperu and David; Rif and Ciriperu 2005; Serban 2004; Ziarul Financiar 2006d; Rif 2006b; Economistul 2006). These plants are integrated into the Central European transnational automotive cluster that expands across six countries. Plastique Forme (France), for instance produces in Timisoara especially for the PSA (Peugeot-Citroen) factory in Trnava (Slovakia) (Bonoiu 2004c). These findings confirm Havas’ (2000: 257) theory that in Central Europe foreign investors in the automotive sector are organizing their activity at a regional rather than national level (also in Kukely and Czira 2005). Due to a growing shortage of labor in Western Romania, many foreign automotive

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157 However, more recently some of these plants have won contracts with Dacia. For instance, in 2005 a contract was signed between BOS Automotive and Dacia that included the German parts manufacturer among the suppliers of the new Logan model (Central Europe Trust Company 2006).
companies now prefer to locate in Central Transylvania especially along the two
planned motorways that will connect Bucharest to Hungary (see figures 7.1 and 7.2).

While FDI is important in providing employment there seem to be few
linkages between foreign automotive companies and local economies other than for
certain types of services. Perhaps aware of this concern, foreign investors have
begun to relocate more value-added activities like research and development in
Romania. For instance, Continental opened such a center in Sibiu and hired 200
engineers (Bonoiu and Marin 2005; Edmondson et al 2005). Additionally 200
employees will work in a research institute that Ruwel plans to open in Cluj.
Initially engineers from Germany will realize the computer editing design and
computer editing manufacture for Ruwel’s operation in Cluj. Once the institute is
established, Romanian specialists will be hired to work on technical innovations and
on designing new products for the company’s global operations (Ziarul Financiar
2006e). Also Siemens VDO Automotive inaugurated in 2006 its R & D center in
Iasi while Autoliv opened such a center in Timisoara to design electronic
components for safety systems (Mocanu 2006; Curierul National 2006; Bulzan
2006). Lars Westerberg, president and executive director of Autoliv has recently
declared that this transfer of engineering resources to low-cost countries represents
the third step in the company’s strategy to reduce costs (Curierul National 2006).

Most recently, Renault has announced a 500 million euro investment (more
than US $600 million) in a R & D center in Romania to design new auto models for
emerging markets. This is the first such center opened by Renault outside France. It
currently employs several hundred engineers and technicians, most of them
Romanians, but when fully developed, the center will employ 3000 people, of which
2,300 will be college educated (Serban 2006; Business Magazin 2006; Evenimentul
Zilei 2007a).

All these research centers are situated in college cities. Cluj, Iasi and
Timisoara represent the second-, third- and fourth-ranked university centers in
Romania. Sibiu also boasts a small university. Wolfgang Dehen, president of
Siemens VDO Automotive recently declared that the company had chosen Iasi for
its new R & D center because of the city’s university tradition and because of the
high IT skills of Iasi University graduates (Mocanu 2006). Another top executive of
Continental stated that “Partnering with universities in the area is key to success”
(Central Europe Trust Company 2006: 271).

**7.6 Conclusion**

The automotive industry remains one of the most attractive economic sectors in
terms of foreign investment. Multinational companies have invested in Romania
because its cost of labor remains among the lowest in Europe. Romania (and
especially Western Romania) is also easily accessible from Central and Western
Europe where these companies have other operations. With accession to the
European Union on January 1st 2007 trade operations have become simpler. The
significance of the automotive sector is demonstrated by the fact that 24 foreign-
owned auto parts manufacturers rank among Romania’s top 200 importers and
exporters. The Central Europe Trust Company report (2006) suggests that an
“automotive lohn” will slowly replace “textile lohn”\(^\text{158}\). However, in other ways the impact of foreign-owned automotive companies on local economies is quite limited. Very few firms buy from or supply to domestic companies. Even when they collaborate with local companies the favored partners tend also to be foreign-owned.

These observations all point to the fact that the most important impact of automotive FDI on local economies and communities in Romania is the provision of jobs. Most of these investors are in Romania because of low wages for skilled workers and reasonable access to assembly plants in Central and even Western Europe from western Romania.

A second conclusion is that rather than being embedded locally foreign-owned automotive companies are integrated into global or continental networks. Most of these companies are multinational corporations. They search globally for the most competitive suppliers and, at the same time, supply multiple customers and multiple locations of the same customer (or group alliance like Renault-Nissan-Dacia). Domestic companies are limited in their ability to tap into these networks given their outdated technology, long standing isolation from the major centers of innovation, and their limited production capacity. Unless they enter into joint ventures with western companies then their prospects are limited and the most they can hope for is to become lower-tier suppliers.

\(^{158}\) “Production in Lohn” is the name under which Outward Processing Transit (OPT) practices are known in Romania. Under this system (dominant in the Romanian textile and garments industry), all necessary parts and supplies are provided by the foreign customers and production is then entirely re-exported to customer’s country. The sourcing of supplies, design of models, marketing, advertising and selling of final products is all done by the customers. The domestic company provides little more than labor.
Chapter 8: FDI IN THE TEXTILE, CLOTHING AND FOOTWEAR SECTOR

8.1 Global Trends in the Textile, Clothing and Footwear Industry

The textile, clothing and footwear (TCF) industry is one of the least capital and knowledge intensive of all manufacturing sectors which makes it a logical starter for developing countries in their attempt to industrialize (Gereffi 1999). In general, factories are small, especially those producing clothing. The smaller size allows them to be more flexible in the face of a constantly changing pattern of demand. In Eastern Europe the majority of companies in this sector are small although the companies that survived since communist times tend to be rather larger (Dicken 2003).

Contrary to the automotive industry this sector and especially the clothing industry could be seen as a buyer-driven production chain (Dicken 2003; Stengg 2001; Dunford 2002; Nordas 2004). Very rarely have transnational companies set their own factories in low labor cost areas (as is the case for the automotive industry); in most cases they prefer to license their brand name to local producers and then import their products or engage in subcontracting with local factories (Begg et al 2003).

At the same time, retailers are consolidating in large trans-national corporations which gives them great leverage when negotiating with textile and garments manufacturers (Perivoliotis 2004; Faust 2005). By starting to source their products globally retailers have increased pressure on manufacturers to lower prices. Since labor costs represent 60% of total production costs many companies from the
developed world have started to outsource their production capacities to countries in the developing world. Western European companies, for instance have relocated much of their production to Central and Eastern Europe (Dicken 2003).

Gereffi (1999) has identified three types of lead firms in the textile, clothing and footwear sector: retailers, marketers (“manufacturers without factories” like Ralph Lauren or Nautica) and branded manufacturers (which organize their production through OPT\textsuperscript{159}-type systems or export processing zones). All three types of lead firms are producing directly or indirectly in Eastern Europe.

Initially the clothing industry was the first to delocalize due to the more labor intensive nature of this industry. However later the textile industry proved to be more sensitive to price due to the fact the industry was already using high technology which left little room for improvement, while the clothing industry has better survived in the EU due to recent technological improvements which increased productivity and subcontracting the more labor-intensive phases of the production to countries with much lower labor-costs (Taplin 2004).

Textiles were more capital and technology intensive and labor costs represent a much smaller percentage of total production costs therefore savings in case of outsourcing are much less important than in the case of clothing or footwear industry. Also the European rules of origin stipulation required firms using OPT trade to contract raw materials from the European Union (Taplin 2004).

\textsuperscript{159} Outward Processing Trade- the term will be explained later in this chapter.
8.2 Changes in the European Textile Industry

Although it still accounts for an important percentage of manufacturing production and employment, the importance of the Textile, Clothing and Footwear sector in Europe has constantly been declining. In 2000 it still accounted for 5.3 percent of manufacturing production and for 9.3 percent of manufacturing employment (Hanzl-Weiss 2004: 924). However the number of employees in this sector is decreasing constantly. It was reduced by more than 1 million between 1990 and 2000, representing a 31 percent decrease (Hanzl-Weiss 2004: 925). After 2000 the drop in the number of employees has accelerated. Between 2004 and 2005 alone, the number of employees in this sector decreased by 6.9 percent to reach a little more than 2.2 million (Eurostat 2006; table 8.1). The number of firms in this sector has also dropped significantly. Also affected are their annual turnover and investment.

<table>
<thead>
<tr>
<th></th>
<th>2005 (end of the year)</th>
<th>% Growth 2004-2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total employment</td>
<td>2,218,729</td>
<td>-6.9</td>
</tr>
<tr>
<td>Total number of firms</td>
<td>154,866</td>
<td>-6.1</td>
</tr>
<tr>
<td>Turnover (billions of euros)</td>
<td>198,0</td>
<td>-4.8</td>
</tr>
<tr>
<td>Investment (billions of euros)</td>
<td>5,1</td>
<td>-3.3</td>
</tr>
</tbody>
</table>

Table 8.1: The decline of the Western European TCF industry after January 1, 2005. Source: Eurostat (2006, based on data from EURATEX).
One of the characteristics of the European TCF companies is their small size. Unlike the trend in the auto industry, companies in the TCF sector have resisted the urge to grow. This sector was very little affected by the merger and acquisition wave that have characterized other manufacturing industries especially in the 1990s. European TCF companies have pursued different strategies in order to survive. They have outsourced the most labor-intensive phases of production, while focusing on R & D and marketing. They have also focused on higher end products and, instead of engaging in mergers and acquisitions have chosen to maintain and develop the subcontracting system which allowed them to stay more flexible and to ensure shorter delivery times.

Enterprises of less than 50 employees represent more than 60 percent of the workforce in the EU clothing sub-sector (and 38 percent of all workers in the clothing industry are employed in factories with less than 20 workers) and produce close to 50 percent of the value added (Taplin 2004). In 1999 the average European textile and clothing company had 19 employees. There is however a high degree of cooperation both horizontally and vertically as many of these companies are linked together through subcontracting relationships. The industry is also often organized in clusters (Stengg 2001; Dunford 2002) and often in industrial districts (as discussed in chapter 6).

While the importance of the TCF sector in Western Europe is fading, it has become more important for the countries in Central and Eastern Europe that joined the European Union after 2004. These countries make up seven percent of textile, clothing and footwear production and 55 percent of employment in the European
Union pointing to the much lower productivity of this sector in the accession countries (Hanzl-Weiss 2004). In terms of production, Poland ranked first in 2002 followed by Romania while in terms of employment Romania ranked first in the same year with 450,000 people employed followed by Poland (290,000) and Bulgaria (170,000) (Hanzl-Weiss 2004: 929). Although the number of employees has decreased more recently Romania and Bulgaria are still at the bottom of the list in terms of productivity. In these two countries employment in the textile, clothing and footwear industry represent 30 percent of total employment in the manufacturing sector\textsuperscript{160} which point to the importance of this sector in providing employment especially for the female population (Hanzl-Weiss 2004: 930).

\textsuperscript{160} Textile and clothing industry concentrated 7 percent of manufacturing employment in EU-25 (in 2002) while in Eastern Europe these figures are much higher: Hungary (12 percent), Poland (11 percent) and the Czech Republic (9 percent) + Baltic States (17-24 percent), Bulgaria (28 percent) and Romania (24 percent). (Heymann 2005: 21).
On the other hand, several measures were employed in order to save this traditional sector in the European Union. Among these the complete restructuring of the industry by turning to higher value-added products and increasing productivity through adoption of better technologies (including information and communication technologies) and outsourcing of labor intensive processes to countries where labor costs are much lower (like Eastern Europe) (Hanzl-Weiss 2004: 927).

Trade of textile, clothing and footwear between Western and Eastern European countries has continuously increased during the 1990s and during the first years after 2000 reflecting the importance of the OPT relationship. By 1999, between 74 and 91 percent of accession countries’ exports of textile and clothing
and between 58 and 97 percent of their exports of footwear was directed towards the EU with Romania having the highest shares in both industries. On the other hand these countries imported between 65 and 86 percent of their textile and clothing needs and between 50 and 91 percent of their footwear needs from the EU-15, with Bulgaria and Romania having again the biggest share (Hanzl-Weiss 2004).

Figure 8.2: Top 10 clothing suppliers to EU-15 in 2003.
To better grasp the scale and the importance of this trade especially for the Eastern European countries we should mention that up to 90 percent of domestic production in the TCF sector in Romania and Bulgaria is exported. In these two countries exports of textiles and clothing accounted for around 25 percent of total exports in 2003 (Heymann 2005: 22). The surge in wages after 2000 has brought some changes in the production of TCF in Eastern Europe. For clothing, for example, between 2000 and 2004 production fell in the more developed accession countries like Poland (-17 percent), Czech Republic (-12 percent) and Hungary (-3 percent) while it expanded in Romania (+18 percent) and Bulgaria (+91 percent). Textile production fell in Hungary (-23 percent), but remained the same in Czech Republic. On the other hand, Poland (+16 percent), but especially Romania (+51
percent) and Bulgaria (+120 percent) have seen a boost in their production (Heymann 2005: 22).

Most central and eastern European exports of apparel take place within the framework of subcontracting with firms from Western Europe (Freundenberg and Lemoine 1999). In 2000, 76.5 percents of all OPT imports and 84.4 percent of fashion industry imports to Germany came from the CEE countries (Faust 2005). On the other hand CEE countries lack strong brands to penetrate the EU markets and rely on German and other EU brands for their exports (Faust 2005).

8.3 International Agreements on Textile and Clothing

Eastern European manufacturers have become the preferred business partners for Western European producers for several reasons (Hanzl- Weiss 2004; Heymann 2005; Graziani 1998):

1. Low labor costs;
2. Geographical proximity which presents important advantages in terms of transportation costs and delivery times and allows for a greater flexibility;
3. There has been a long tradition of collaboration between Western and Eastern European firms in the textile, clothing and footwear sector dating back to the 1970s or even earlier;
4. Trade regulations between the European Union and the accession countries were also in favor of outsourcing.
One trade regulation that explains the importance of Eastern Europe for Western European companies is the Multi-Fiber Arrangement (MFA) first signed in 1973 and then renewed every four years until 2005. This restricted the presence of Asian textile and clothing exporters on the Western European market through higher tariffs and tight import quotas (Dicken 2003). Additionally, starting with the 1980s, the Outward Processing Trade\textsuperscript{161} (OPT) has also contributed to the creation of a pan-European and Mediterranean zone of production in the textile and clothing sector (Smith et al 2005). The OPT agreement stipulated that no duties be levied on clothing or footwear entering a Western European country from Eastern Europe when they were manufactured using raw materials from the same Western European country (Baldone et al 2000; Graziani 1998). Moreover, Eastern European countries were granted an additional quota. Reimported OPT goods were duty-free but reimports within normal MFA quotas were subject to tariffs (Graziani 1998). Duties were levied only on the added value produced abroad and not the full value of the product (Smith 2003). Also the finished product could be considered as being made in the country initiating the OPT which could help with marketing and advertising (Dunford 2002).

Working in the OPT system presented both advantages and considerable risks for firms from the accession countries (Hanzl-Weiss 2004: 933). On the one hand Eastern European manufacturers have gained numerous advantages: had gained access to the Western European markets, had secured constant purchases with which they could pay their employees and had obtained financial support from their Western partners to invest in the restructuring of the factory. More importantly

\textsuperscript{161} Several other terms are used like CMT (cut, make and trim).
they were given access to modern managerial and technical know-how and to specific production skills. On the other hand these very advantages represent the main risks as well. Value-added and profits are generally very low for companies that work in this system which means that the Eastern European companies could not invest on their own. This ties them to the OPT contracts making them very vulnerable to any changes in the global economy as Western contractors could easily shift production to other countries when labor costs increase too much (Hanzl-Weiss 2004: 933; Smith et al 2003; Smith et al 2005; Smith et al 2004). Also, as mentioned earlier until recently, OPT and EU regulations favored the production of clothing rather than textiles in the Eastern European countries (Pincheson 1995).

Jointly these factors encouraged the relocation of many companies from Western Europe to Eastern Europe resulting in the growth of employment and output in this sector across many of these former socialist countries (Smith et al 2005; Smith et al 2004; Begg et al 2003; Smith 2003)

8.4 Textile, Clothing and Footwear Industry in Romania

In Romania this industry is much younger than in Western Europe. Small spinning and weaving mills date back to the 16th Century and were clustered around the traditionally German towns of Sibiu and Brasov (Pincheson 1995). However, larger scale textile and clothing manufacturing first appeared in Romania in the 1800s when the first spinning mills were established at Azuga (not far from Brasov), Buhusi (Bacau County) and Iasi (Pincheson 1995). The first clothing factory started
in 1849 in Bucharest to manufacture mainly uniforms for the military (Pincheson 1995). The industry really took off in the interwar period when in an attempt to limit imports, the government offered domestic producers substantial incentives and protection from imported products (Pincheson 1995).

After the World War II, with the advent of communism all factories were nationalized and many more textile and clothing factories were built. The new factories differed from those opened in previous periods by two major characteristics. Firstly, they were in general much larger than previous ones, with Confex in Bucharest employing 20,000 workers by the end of the 1980s. Secondly, the new factories were more evenly spread across the country (as opposed to earlier factories which tended to cluster in certain areas). The aim was industrialization of all regions and counties and providing employment for surplus female labor in areas in which mining and heavy industry were dominant, these industries employing mainly males (Pincheson 1995). The industry before 1989 was mainly export oriented but it was very inefficient due to obsolete technology and overstaffing.

After 1990, with the fall of Communist regimes in Eastern Europe, the traditional export markets, and especially the vast market of the Soviet Union were lost and there was a sharp decline in production. In the textile industry the decline was also due to the collapse of other sectors which supplied the raw materials like the petrochemical sector (Pincheson 1995).

Many factories were operating at one-quarter or less of their capacity. Workforce had to be significantly reduced\(^{162}\), but still salaries could hardly be paid.

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\(^{162}\) Before 1989 in Romania, 600,000 employees worked in the Romanian textile and garment industry (Pincheson 1995).
The obsolete equipment was also making production painfully inefficient. Raw materials were hard to find and prices were escalating while the quality of these materials from domestic sources was plummeting. Lack of hard currency was making importing very difficult. At the same time Romanian textile manufacturers had lost their traditional market and were not competitive on the western market which made selling their products an even more difficult task. Many factories resorted to barter in order to reduce their stock or acquire the necessary supplies for the production process (Pincheson 1995).

In the clothing sector the main problems were somewhat similar and could be synthesized as follows (Pincheson 1995):

1) excess workforce;
2) obsolete equipment;
3) inadequate quality control;
4) outdated design, not competitive on the international market;
5) problems with raw material supplies on the domestic market;
6) modest domestic market size especially in terms of purchasing power.

Due to all these problems, at the beginning of the 1990s, the Romanian TCF sector was in a state of near collapse. On the other hand, the very low wages\textsuperscript{163} attracted an increasing number of foreign entrepreneurs who subcontracted production capacities with the Romanian companies. OPT was not a new phenomenon in Romania. Some state-owned enterprises have been engaged in OPT relationships with Western firms since the end of the 1970s (Chis et al 2004). Foreign investors in the Romanian TCF

\textsuperscript{163} In 1999 unit labor costs in the footwear sector for example in Romania, Bulgaria, Lithuania and Poland were 30-40 percent of the EU level (Hanzl-Weiss 2004).
sector subcontracting with Western companies helped the industry survive in times of crisis.

In 2000 Romania was the fourth most important exporter of clothing to the European Union\textsuperscript{164} with 5.4 percent of the Union’s imports\textsuperscript{165} (Begg et al 2003; also in Hanzl-Weiss 2004). In Romania, the TCF industry accounts for 5.5 percent of GDP, 9.9 percent of industrial production and 34 percent of exports and generates revenues of $4.5 billion per annum (Budurca 2005; The Economist 2005). More than 62 percent of the revenue is generated by the clothing industry, 22 percent by textile and 15 percent by the leather and footwear industry (Budurca 2005). Also 97 percent of this sector is privately owned (Budurca 2005).

More than 430,000 people were employed in this industrial sector in 2002, representing 21.2\% of total manufacturing employment, the highest in Central and Eastern Europe (Begg et al 2003). In the town of Calarasi, for example, out of the 80 enterprises with more than 20 employees, 34 are involved in textile and clothing industry (Moldovan and Stefan 2005). Many multinational companies, including Steilmann (Germany), Marks & Spencer (U.K.), Arcadia Group (U.K.), Dorothy Perkins (U.K.), Stefanel (Italy), Sears (USA), Levi’s (USA), Pierre Cardin (USA), Hugo Boss (Germany) and Gianfranco Ferre (Italy) own their own factories in Romania or subcontract with Romanian companies (The Economist 2005).

According to the National Trade Register Office (2007), a number of 37,706 TCF companies had been registered between December 1990 and November 2006.

\textsuperscript{164} In 2001 Romania was the largest Central and Eastern European exporter of textiles, clothing and footwear (Hanzl-Weiss 2004).

\textsuperscript{165} For Italy, Romania represent the most important trade partner; almost half of all Italian imports of clothing from Eastern Europe come from Romania (Grazziani 1998).
Of these 11,676 (or 31 percent) were in textile industry, 20,785 (or 55 percent) in the clothing industry and 5,245 (or 14 percent) in the leather processing and footwear industry. A number of 7,988 (21 percent) of these companies, however, are very small employing only the owner or the owner and his family (2,361 of these are in the textile industry, 4,723 in the clothing industry and 904 in the leather processing and footwear industry).

At the end of 2006, a number of 3060 of these companies were foreign-owned, representing 8.1 percent of the total number of companies in this sector. Although there are foreign companies in all counties the distribution is not even (figure 8.4). A preference of foreign investors for the three regions in Transylvania and especially for the western strip (Bihor, Arad and Timis counties) is quite evident from map. Another observation is that there are also more TCF foreign-owned companies in counties with more population or counties with a larger city. This is true also for the regions outside of Transylvania, although there are two notable exceptions (Constanta and Galati counties) which have very few foreign investments in this sector.
Figure 8.4: Number of foreign-owned firms in the TCF sector. Source: Based on data from the National Trade Register Office (2007).

When analyzing the number of foreign-owned companies in the TCF sector per 100,000 population (since counties are not equal in terms of population), the dominance of Transylvania becomes even clearer (figure 8.5). However when examining the number of foreign investments in the TCF sector as a percentage of total foreign companies, more peripheral counties in the east and south (Botosani, Vaslui, Braila, Buzau, Teleorman and Olt) seem to be more important (figure 8.6). These counties have seen fewer foreign investments in general but seem to be more attractive to investors in the TCF sector than in other economic sectors perhaps because they are seeking low labor costs rather than seeking a market for their products (in which case they would tend to prefer counties with a better economic outlook).
Figure 8.5: The number of foreign-owned companies in the TCF sector per 100,000 population.
Source: Calculations by the author based on data from the National Trade Register Office (2007) and The National Institute of Statistics (2006)

Figure 8.6: Percentage of foreign-owned companies in the TCF sector of the total number of foreign investments.
Source: Based on data from National Trade Register Office (2007; 2006)
The following research is based on fieldwork done during the summers of 2005 and 2006. It involved an extensive survey followed by personal interviews with factory owners and managers as well as interviews with local authorities and with representatives of several Romanian agencies like the Romanian Agency for Foreign Investments, the National Institute of Statistics and the National Trade Register Office.

8.5 Methodology and Results of Research

A survey was sent to 434 companies with foreign ownership representing 14.2 percent of total foreign owned companies in this sector. The list of companies was obtained from the National Trade Register Office which at my request did a random selection. A reminder was sent three weeks later. A number of 27 letters were returned to the sender for various reasons. In most of these cases the company has moved and the new address was unknown. Other reasons included: wrong address, company failed and in two cases the owner refused to answer the questions for reasons of confidentiality. When companies had an electronic address an email was sent which was again followed up by a reminder.

Eventually a number of 24 responses were received representing a 5.9 percent response rate. These were followed up by seven more in-depth interviews of which two were in person and five over the phone. Written media analysis also provided a good number of interviews with owners, shareholders or managers of foreign-owned companies in the textile, clothing and footwear sector including
several interviews with Maria Grapini, the president of Fepaius, the organization representing the interest of business owners in this industry.

All companies that accepted to participate in the survey are from Europe. Of the 24 companies, nine are Italian, five German, four British, one French and one claims EU nationality while four companies have Romanian majority capital and foreign minority shares. These companies have an average of 2.57 operations or affiliates mainly in Western Europe but also in Asia, Africa, Latin America and in other countries in Central and Eastern Europe. However, eight out of the 19 companies that answered this question only had operations in Romania. Moreover, 15 out of 23 companies had only one factory in Romania, while four companies had two factories, three companies had three factories and one had five factories. These point to the relatively small size of companies in this sector and to their preference for subcontracting rather than vertical or horizontal expansion. Although these companies worked for some of the most famous companies in the world in this sector they were not owned by these companies and in several cases contracted with more than one Western company.

The oldest of the surveyed companies date back to 1973 and 1975 when they were still state-owned. Most of the companies started their operations in the 1990s (table 8.2). Also 19 out of the 24 companies started as greenfield investments and two as joint ventures while three were formerly state-owned companies acquired by foreign investors. Today, more than half (eleven) of the companies that answered this question are wholly owned foreign affiliates and nine companies are joint ventures where the Romanian ownership represent between five and 60 percent.

166 Some companies elected not to answer all questions.
<table>
<thead>
<tr>
<th>Period</th>
<th>Number of companies</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 1996</td>
<td>11</td>
<td>45.8</td>
</tr>
<tr>
<td>1996-2000</td>
<td>7</td>
<td>29.2</td>
</tr>
<tr>
<td>2001-2003</td>
<td>4</td>
<td>16.6</td>
</tr>
<tr>
<td>2004-2005</td>
<td>2</td>
<td>8.3</td>
</tr>
</tbody>
</table>

Table 8.2: Period of investment.

The surveyed companies have between six and 1540 employees (both at the factory and country level). The number of employees has in general increased (in many cases considerably) since the first year of operation with between 12.5 percent and 1200 percent. Only two companies reported a drop in the number of employees with 20 and 50 percent respectively.

8.5.1 Determinants

One of the objectives of this research was to investigate the main factors that have influenced foreign investors’ decision to invest in Romania. Based on the survey results, the most important reasons for foreign investment in the TCF sector are the possibility of finding relatively cheap and highly qualified labor and the possibility of lowering operating costs in general (table 8.3). Another important factor is proximity to the EU market. This is a major advantage for Romania compared to China or other cheaper countries in Asia since distances from Romania to any destination in Europe could be covered in no more than two-three days but most destinations in Northern Italy, from where an important percentage of foreign investors are from are within one day of driving (Martin and Straubhaar 2002; Banat Business 2004).
Table 8.3: Main factors for foreign investments in the Romanian TCF sector (1 = not important; 4 = very important).

<table>
<thead>
<tr>
<th>Factor</th>
<th>Average</th>
<th>Median</th>
<th>Mode</th>
<th>Number of responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low labor costs</td>
<td>3.50</td>
<td>4</td>
<td>4</td>
<td>22</td>
</tr>
<tr>
<td>Skilled labor</td>
<td>3.39</td>
<td>4</td>
<td>4</td>
<td>23</td>
</tr>
<tr>
<td>Low operating costs</td>
<td>3.35</td>
<td>4</td>
<td>4</td>
<td>23</td>
</tr>
<tr>
<td>Proximity to EU</td>
<td>2.63</td>
<td>3</td>
<td>3</td>
<td>22</td>
</tr>
<tr>
<td>Proximity to partner, supplier or customer, already in Romania</td>
<td>2.05</td>
<td>2</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>Other cultural affinities: language, religion, etc.</td>
<td>2.00</td>
<td>2</td>
<td>1</td>
<td>21</td>
</tr>
<tr>
<td>Political stability</td>
<td>1.95</td>
<td>2</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>Romanian government investment policies and incentives</td>
<td>1.91</td>
<td>2</td>
<td>1</td>
<td>21</td>
</tr>
<tr>
<td>Market potential</td>
<td>1.82</td>
<td>1.5</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>Market size (population)</td>
<td>1.72</td>
<td>1</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>Owner, CEO or other executive is of Romanian decent or has family in Romania</td>
<td>1.64</td>
<td>1</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>Proximity to other countries in Eastern Europe</td>
<td>1.62</td>
<td>1</td>
<td>1</td>
<td>21</td>
</tr>
<tr>
<td>Other (please describe below)</td>
<td>1.50</td>
<td>1</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>Previous commercial relationship with the Romanian partner;</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proximity to Russia and other former Soviet Union republics</td>
<td>1.45</td>
<td>1</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>Market strength (spending power)</td>
<td>1.36</td>
<td>1</td>
<td>1</td>
<td>22</td>
</tr>
<tr>
<td>Raw materials</td>
<td>1.32</td>
<td>1</td>
<td>1</td>
<td>22</td>
</tr>
</tbody>
</table>

Other reasons were also considered somewhat important in influencing foreign investors’ decision to establish their businesses in Romania. Some investors have chosen Romania following their partners, suppliers or customers who have invested in Romania previously (score 2.05). Cultural affinities were also found somewhat important (2.00). All other factors were considered of very little importance. They all reflect the importance of OPT relationships with Western European partners where raw materials are provided by the clients; therefore their availability locally and their price are not considered important. Also most of the
production is re-exported to Western Europe so that domestic market size, strength and potential are less important in the eyes of foreign investors. Also, since very little is exported to the former Soviet Union and other Eastern European countries, proximity to these markets is not considered important.

The respondents have also identified a series of problems that make investments in Romania more difficult (table 8.4). Most of them complained about the frequent changes in legislation. An especially delicate problem is fiscal instability especially the contribution investors need to make towards their employees taxes which was considered very high. This significantly increases the costs of operating in Romania. Work ethics of many employees is also an issue raised by many respondents. Good workers are more and more difficult to find and the labor legislation protects employees more than their employer. Cumbersome bureaucracy was also a leit motif of the surveyed foreign investors. And finally the underdeveloped infrastructure also makes difficult to invest in certain areas. The responses presented in the table below are very similar to the main problems raised by foreign investors in the TCF sector in a meeting with Romanian authorities in Botosani167 (Turp-Balazs 2005).

167 At that meeting foreign investors have identified the following problems (Turp- Balazs 2005):
1) The strengthening of the Romanian currency against the euro and the dollar, which has had a strong impact on exports;
2) The rising prices for utilities;
3) The rising costs with wages, sick leaves and maternity leaves;
4) Lack or shortage of labor;
5) Lack of or underdeveloped infrastructure which make access to areas like Botosani difficult for foreign investors;
6) Fiscal code permits the intrusion of the state in private company matters;
7) Frequently changing fiscal code;
8) The disappearance of the textile industry which forces the clothing industry to rely on imports;
9) Lower productivity level compared to the Western European countries;
The most important problems for foreign investors\textsuperscript{168} & Number of respondents expressing concern \\
Frequently changing legislation & 11 \\
Work ethics + labor law favoring employees over employers & 5 \\
Underdeveloped infrastructure & 5 \\
Bureaucracy & 4 \\
Increasing operating and labor costs & 2 \\
Fiscal instability + high taxes & 2 \\
Political instability & 2 \\
Commercial legal system – long and complicated procedures & 1 \\
Lack of information & 1 \\

Table 8.4: Main deterrents for foreign investment in the Romanian TCF sector.

In terms of site selection, none of the listed factors was considered very important for investors in this sector which partly explains why foreign-owned companies are spread more evenly across the country than foreign investments in the automotive industry (table 8.5). The most important factor in site selection refers to previous linkages with (a) Romanian company or companies in the region followed by land (or space) availability. Also somewhat important is considered the distance from international markets or customers (which may explain why counties with big cities or close to big cities have received more investment than other counties). We can also add the existence of good communication and transportation links which incidentally also favor locations in western Romania and in or close to big cities.

\textsuperscript{10} Labor legislation favoring employees and the work ethics of many Romania which still leaves much to be desired.

\textsuperscript{168} This was an open-ended question; therefore, the responses are not standardized but they were amazingly similar.
For some investors the attitude of local authorities towards foreign investors was somewhat important. Due to low value-added, low levels of taxes generated, low wages and low base multiplier\(^{169}\), local authorities are generally less enthusiastic about supporting such projects. Only in areas with high unemployment rates may local authorities go out of their way to attract foreign investors in this sector and even when this happens foreign investors are offered few incentives if any at all.

Cultural similarities, although acknowledged as somewhat important by some investors turned out to be less important than previously thought. Least

\(^{169}\) Meaning it generates few other jobs, in services for example.
important factors for site selection, besides local incentives, were the existence of suppliers, customers or competitors that have located there previously (which was somewhat expected since most relationships are with firms located abroad) and the quality of life. In the latter case, actually the opposite may be true; rural areas with high unemployment rates may be more attractive for these foreign companies than big cities where the quality of life and the cost of living may be much higher and as a result wage expectations may be higher as well.

### 8.5.2 Embeddedness

Working in the outward processing trade system, most of the foreign investments in the textile and clothing sector appear to be relatively disembedded. However, the degree of embeddedness may vary from region to region as well as with the country of origin and the form of investment (privatization or greenfield). Baldone et al (2000) examined the patterns of investment in the textile, garments and footwear industry in Central and Eastern Europe and distinguished two models. According to this study, Dutch and German firms tend to delocalize a larger number of phases of the production process, whereas French and Italian companies are inclined to outsource to Eastern Europe only the finishing phases of production. Another finding of the above mentioned study is that once the outsourcing process has started, the tendency for EU firms is to delocalize an increasing number of upstream phases to the initial country of investment rather than moving to countries with lower labor costs as a reaction to increasing wages.
Also several studies on Italian investments in the Timisoara area have shown that the degree of embeddedness of this type of investment in the local economy is increasing due to the strategy to subcontract different phases of the production process to local companies (Spaventa and Monni 2005; Majocchi 2004; Montagnana 2005). Spaventa and Monni (2005) argue that the establishment of local firms in Timisoara by companies from the Veneto Region is actually only a way of managing the subcontracting process. “Thus, linkages between Veneto’s firms and local Romanian firms are stronger and deeper than in the classic FDI case” (Spaventa and Monni 2005: 17).

Moreover, as mentioned earlier, most Italian firms in the TCF sector are embedded in relationships specific to industrial districts and when moving to Romania the relationship between the leader companies coming from Italy and partner corporations, both Italian and Romanian, tends to reproduce the relations that have existed in the Italian industrial district on an international level (Majocchi 2000: 7). Because of the tight relationship that exists between firms within an industrial district, the first movers to Romania were soon followed by other companies, customers, suppliers and competitors as well as banks and other service firms. As a result of this process, Spaventa and Monni (2005) argue that an industrial district is already forming in Timisoara.

The second objective of my study was to assess the degree of embeddedness of foreign-owned companies in the Romanian TCF sector. The relatively small number of responses did not allow for a distinction in the level of embeddedness between companies of different nationalities; therefore I cannot support or reject
results from previous research. However, many other conclusions could be drawn from this research.

Less than 20 percent of material supplies were acquired from the local or regional economies. Only one company reported sourcing 60 percent of their material supplies from the regional economy. The same company buys 100 percent of their material supplies from Romania. Other than this company the maximum sourced from Romania was 30 percent but the majority of respondents reported between 0 and 20 percent. Material inputs sourced within the local economy are generally provided by Romanian-owned businesses. There is very little collaboration with other foreign-owned businesses. In general the surveyed companies do not source from local or regional suppliers because the material inputs are not available at local level or when they are available they are of inferior quality and/or generally more expensive. Also, in many cases the head office, parent company or customer (in the case of OPT relationships) is directing the factory managers to buy from certain suppliers which are generally located outside the local economy and, in most cases located abroad (table 8.6).
<table>
<thead>
<tr>
<th>Reasons</th>
<th>Number of responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>The material inputs are not available from suppliers within the local economy</td>
<td>14</td>
</tr>
<tr>
<td>The materials are available from suppliers within the local economy but they are of inadequate quality</td>
<td>6</td>
</tr>
<tr>
<td>The material inputs are available from suppliers within the local economy region but they are too costly</td>
<td>3</td>
</tr>
<tr>
<td>We have an established relationship with a supplier from outside the local economy who we prefer to use</td>
<td>2</td>
</tr>
<tr>
<td>Our head office or parent company directs us to use certain suppliers from outside the local economy</td>
<td>8</td>
</tr>
<tr>
<td>Other reasons</td>
<td></td>
</tr>
<tr>
<td>• We are working in the OPT system;</td>
<td></td>
</tr>
<tr>
<td>• Material inputs should be from a supplier accredited by our holding;</td>
<td></td>
</tr>
</tbody>
</table>

Table 8.6: Reasons that best explain the plant’s decision to use non-local suppliers (respondents could select more than one answer).

Conversely more than 50 percent of all material supplies are from the investors’ home countries. Only in one case the percentage was much lower (15 percent). Also not surprisingly most of the material supplies are sourced from the European Union (12 out of 15 respondents reported percentages of 60 percent or higher. Only three respondents mentioned that 10-30 percent of their material supply needs were sourced from countries other than their home country or the European Union (China, India and Turkey). Seven out of 15 surveyed companies obtain 100 percent of their material inputs from other factories of the parent group while three other companies contracted 95-99 percent of their inputs from other affiliates of the parent company. Since previous answers indicated that very few of the surveyed companies had more than one operation, we must assume that the
respondents refer here to other companies and factories with which their main contracting company (customer) has business relationships.

Less than five percent of the final products are sold on local and regional markets. One company reported selling 100 percent of their final products in Romania and for another company Romania was the destination of 80 percent of their products. Besides these two examples no more than 30 percent is sold on the domestic market. Most companies are exporting all or almost all (95-99 percent) of their production, mainly to their home countries (70-100 percent; one exception of ten percent) and to the European Union (70-100 percent with two exceptions of 30 percent each).

Three companies were also exporting to countries outside the European Union between nine and 100 percent of their production. Only six companies (out of the 14 that answered this question) have sold their final products to other affiliates of the parent group. Whereas material supplies are mostly imported, services in general were contracted with Romanian firms, in many cases local and regional.

8.6 Conclusion and Future developments

The TCF industry is one of the most globalized because it is one of the least capital- and knowledge-intensive industries and one of the most labor-intensive manufacturing sectors, the TCF industry is one of the most globalized industries. The strategies employed by TCF companies in the developed world to mitigate the effects of globalization are different from those in the automotive industry. TCF companies have generally remained small while increasing collaboration through
subcontracting within clusters called industrial districts. This helps them stay very flexible and competitive. Many companies from the developed world have also chosen to outsource their entire production or just the most labor-intensive phases of the manufacturing process to the developing world.

Thus, numerous companies from Western Europe have relocated their production to Eastern Europe. This move was also facilitated by two international trade agreements in the industry (the Multi-Fiber Arrangement, first signed in 1973 and discontinued in 2005, and the Outward Processing Trade Agreement). The TCF industry in Eastern Europe was in a state of near-collapse at the beginning of the 1990s but it benefited greatly from Western European companies’ need to find cheaper labor. These trade agreements practically saved the TCF industry in Central and Eastern Europe from collapse.

This study has confirmed that the main factor influencing the interest of foreign investors in the Romanian TCF sector is the low cost of highly qualified labor and low cost of production in general. Proximity to the EU market is considered another advantage of Romania as it allows for short delivery times and increased flexibility when compared to cheaper locations like China. Domestic market size, strength and potential were considered of very little importance by foreign investors as was the availability and price of raw materials. These suggest that foreign investors are not interested in the Romanian market or resources (except labor) as they are producing for the EU market using raw materials provided by the parent company or the customer confirming the importance of OPT relationships for these firms and for the TCF industry in Romania.
The most important problems foreign investors are dealing with in Romania are: the frequently changing legislation and the difficulty of finding and retaining good workers especially as the Romanian labor legislation favors the employees over the employers, followed by an underdeveloped infrastructure which makes investing in certain areas difficult. However, while these problems have bothered many foreign investors they did not deter them from investing in Romania.

In general foreign investors do not have preferences in terms of site selection. The two factors that counted the most for site selection were previous linkages with a Romanian company in the area and land or space availability. Also distance from the EU market was considered somewhat important and therefore sites in the West were often preferred.

The surveyed companies appeared to be rather disembedded as they are involved in OPT relationships with Western European companies. They source most of their material supplies from the home country of their parent company or their foreign partner. Most of their final products are also exported and only services are contracted with local or regional companies.

Another observation is that the surveyed companies appear to be embedded globally within the network of suppliers and customers of their foreign partner company rather than in the regional economy. I was not able to identify differences in embeddedness based on the nationality of the parent company or based on activity (textile, clothing or footwear) due to the small number of responses.

January 1, 2005 brought the complete end of the quota system. This has strongly impacted the Romanian TCF industry. Already the TCF industry is
contributing less to Romania’s exports. Domestic firms used to export 85 percent of their production. Today this number simply plummeted (Roman 2006). Until 2005 this industry gave 32-34 percent of Romania’s exports. In 2006 the contribution of the TCF sector to Romania’s total exports already decreased to 29 percent (Roman (2006) citing an interview with Maria Grapini, president of Fepaious).

The Romanian textile sector is going through significant changes. Many textile factories were privatized to foreign investors who preferred to close them and supply clothing factories with materials from other countries. This contributed to the slow death of the Romanian textile industry (Dialog Textil 2005b). By the end of 2005, 30,000 jobs were already lost (Roman 2006). As a result today, Romania is the only important exporter of clothing without a well developed textile industry (according to Grapini; in Budurca 2005).

Exports of garments and clothing decreased 4.7 percent in January 2006 compared to one year earlier (257.8 million euros or USD 315.5 million). At the same time imports have increased 15 percent (32.2 million euros or USD 39.5 million). The trade balance is still significantly positive (225.6 million euros or USD 276.1 million) although it decreased seven percent against January 2005 (Rachieru 2006). As for the textile industry, production in general dropped between 12 and 70 percent170 (Rachieru 2006). However, exports have increased eleven percent to reach 71.3 million euros (approximately USD 87.3 million) while imports have increased with four percent (198.6 million euros or USD 243 million). The trade deficit remained stable at 128.3 million euros (approximately USD 157 million)

170 The percentage varies between different subsectors of the industry. In a few sub-sectors, production has mildly increased (based on Rachieru 2006).
In the leather and footwear sector, imports increased 15 percent (79.2 million euros or USD 96.6 million) while exports remained the same (109.7 million euros or USD 134.3 million). The trade balance is still positive but dropped 24 percent in 2006 against the previous year (Rachieru 2006).

The number of employees in the TCF sector has also decreased significantly from 435,000 employees in December 2005 to only 380,000 in December 2006. Other 40,000 employees will leave the industry in 2007 bringing the total number of employees to 340,000 which a 21.8 percent drop in only two years (according to Maria Grapini; Evenimentul Zilei 2007b).

The prospects for the Romanian textile, clothing and footwear industry (and implicitly of foreign companies operating in this market) are not looking too good unless major changes are made. The problems are caused by three factors (Hotnews 2005):

1) The phasing out of the quota system after January 1, 2005 which meant that imports from Asia and especially from China were liberalized;

2) The strengthening of the Romanian currency against the dollar and the euro which made Romanian exports more expensive and reduced profits for manufacturers and foreign partners;

3) Continuous pressure from the unions and workers to increase wages.

Further problems are derived from the fact that the Romanian clothing industry has already lost the Romanian market as they have, for many years, focused on exports in the OPT system with the EU being the destination of 85 percent of Romanian clothing exports, market in which Romanian products are already suffering due to
cheaper imports from China\textsuperscript{171} (Hotnews 2005 citing Maria Grapini, president of Fepaius, the organization of business owners in textile and clothing industry).

Experts have different opinions on the strategies Romania needs to adopt in order to mitigate the situation. One set of opinions argues that Romanian firms need to re-conquer the Romanian market. This, however will be a difficult task since the majority of firms specialized in OPT and do not have R & D capabilities anymore and the domestic market is dominated 85 percent by cheaper imports from Asia. Imported garments, however, are of lower quality because they do not adhere to the same standards as Romanian companies (ISO, or Ecotex) which makes the competition unfair. The rules of the game need to be changed to make sure that imported garments and textile are subjected to the same standards (Hotnews 2005).

Some Romanian companies and some foreign-owned companies operating in Romania have started to develop their own brands and are increasingly focusing on the domestic market. For example, “Somesul” from Satu Mare is already producing 75 percent for the domestic market and only 25 percent for their international partners (Chis et al 2004). They have their own clothing collection designed in their own R & D offices and using their own materials. Next, they want to create their own retail chain and to consolidate their position in Russia (Chis et al 2004). Other Romanian brands are already famous not only on the domestic market but also internationally. The best example here is probably Jolidon (lingerie). Founded in 1993, Jolidon has captured important market share in Hungary, Italy and France since expanding there in 2000 (www.jolidon.com). Other companies started

\textsuperscript{171} Moreover, Chinese firms receive subsidies for exports while Romanian firms do not (Hotnews 2005).
to integrate more components manufactured in Romania. However, as Antonio Sarpenti, manager of an Italian company in Romania explains: “We still cannot talk about designs made in Romania because in terms of fashion Milan is still the hub” (Chis et al 2004).

Other industry experts believe that both the EU and China will find it in their interest to continue with some other type of protectionist policies therefore Romanian clothing and textile products will not lose a lot of market share (Hotnews 2005). Moreover it has been mostly the clothing companies that moved their production from EU to Romania and elsewhere in eastern Europe. A second wave will involve textile companies not only from the more advanced countries like Germany or Italy but also from Hungary, Poland or Czech Republic (Hotnews 2005). Also encouraging is the fact that in Romania labor productivity in this industry is one of the lowest in Europe. Therefore increasing productivity could keep the real cost of production in Romania low.

One thing that the government could do in order to reinvigorate the industry is to follow the model of Italian industrial districts and encourage the formation of clusters. Maria Grapini has said that two such clusters are planned for the next few years. One of them will be in Moldova (East) and the other will be either somewhere in Transylvania or around Bucharest (Hotnews 2005).

Although the number of employees in this industry will continue to decline, the Romanian TCF industry is not in danger of disappearing in the next several decades. Flexibility and distance will still be important for lean retailing; low-wages alone are not decisive. Most experts agree that Eastern European producers will not
lose all business to China (Abernathy et al 2002). According to Dr. Johannes Burghold, general manager of Coats Romania, Romania’s main advantage is not low labor costs but rather high quality and flexibility (Dialog Textil 2005).
Chapter 9: Conclusion, Implications and Directions for Further Research

This chapter summarizes the findings of this study and discusses the major conclusions that derive from it. These findings are also analyzed in a broader context linking them to the general literature on foreign direct investment and making parallels to situations in other Central and Eastern European countries. Also, limitations of the data are discussed and further implications of this study are explored. Finally the chapter establishes an agenda for further research.

9.1 Summary of Findings

After World War II, for more than four decades foreign companies were prohibited from investing in Romania. With the change of the political and economic system in 1989, opportunities have opened for foreign investors in Romania. On the one hand, the country’s consumer market was largely untapped, offering many opportunities for market-seeking corporations while the low wages for highly skilled workers were particularly appealing to manufacturers seeking to lower their production costs. On the other hand, in order to successfully transition towards a fully functional capitalist economy the Romanian economy required the capital, modern technologies, know-how and modern Western management techniques these foreign companies could bring. The hope was that foreign direct investment could play an important role in the political and economic transformation of Romania.

The theoretical framework for this research is based on Dunning’s (1980, 1993, 1995, 1996, 2002) paradigm which brings together and is supported by
several other theories on FDI including industrial organization theory, product life cycle theory, the behavioral theory, the portfolio theory, and the internationalization theory. This research has also benefited from Knickerbocker’s (1973) oligopolistic reaction theory.

The main purpose of the study was to investigate the characteristics and patterns of FDI in Romania. I sought to understand how those characteristics and patterns compare to those in other Central and Eastern European countries. A second major objective was to investigate the main factors that have influenced foreign companies’ decision to invest in Romania. Since inward FDI flows are unevenly distributed within Romania, a third question this study has sought to address was why some areas have been preferred by foreign investors over the others. In short, what were their main criteria for site selection? A fourth and final objective was to assess the impact of FDI on local economies.

In order to answer these questions I used a combination of quantitative and qualitative methods. Research was completed in three phases. During the first phase, I compiled and analyzed data from a range of different sources including several Romanian and international agencies. This allowed me to describe the historical evolution of inward FDI flows to Romania since 1990 in the context of Romania’s political and economic transformation. It also allowed me to answer questions related to the major characteristics and patterns of FDI in Romania and to map its distribution.

In the second phase, I used questionnaires to gather information on the main determinants of FDI and on the impact of inward FDI flows on local economies.
Due to the very high number of foreign investments I selected my subjects from only two manufacturing sectors: the automotive sector and the TCF sector. The two sectors are among those most affected by globalization yet each is associated with quite different globalization strategies. Finally, phase three involved in-depth interviews with representatives of a number of selected companies from both industries, industry experts and Romanian authorities at the national and local levels. These interviews allowed for a deeper understanding of the transformations taking place in the two industries and of the role played by foreign investors in those transformations.

9.1.1 Path dependence and Evolution of FDI

Path dependence refers to the idea that the outcome of a process depends on historical events. Therefore, explanation of the outcomes of such processes requires looking at the history rather than analyzing factors at present time. As such, the evolution of FDI in Romania cannot be understood outside its historical context.

In my study, I distinguished three different historical periods, during each of which the role played by foreign investments has varied. During early capitalism (before 1945), FDI played an important role in the industrialization and economic modernization of Romania. The most dynamic economic sectors were dominated by foreign companies. However, this also produced resentment among Romanians who felt uneasy with the fact that foreign companies controlled the most valuable mineral resources and made the Romanian economy dependent on imports, thus eventually affecting the country’s economic and political independence. Images of
unscrupulous foreign investors fueled anti-foreign investment propaganda even after the fall of Communism, throughout the first years of transition.

During the communist period (1947-1989), all businesses were nationalized including the operations of foreign companies. A few foreign companies were allowed to operate beginning with the 1970s but their activity was greatly restricted. Consequently, the impact of foreign investment on the Romanian economy during this period was minimal. However, the strategies adopted by the Communist government to pursue economic development have strongly influenced the pattern of FDI during the first years of transition. Firstly, during Communism Romania’s economy relied on heavy industry using mostly imported materials and creating a dependency on cheap Soviet energy. Secondly, there was a preference for large enterprises, often employing tens of thousands of workers. Thirdly, the Communist government promoted the decentralization of industry and the industrialization of less developed regions of the country in an attempt to equalize economic development across the country, albeit often at the expense of economic efficiency. Fourthly, Romanian industrial policy emphasized the production of industrial goods rather than consumer goods. Fifthly, Romania promoted a full-employment economy, which translated into what were generally seen as chronically overstaffed enterprises and inefficient work practices.

Due to these economic characteristics of the communist state, at the beginning of the 1990s Romania had an economy dominated by an oversized and inefficient industry that was difficult to restructure. Furthermore, popular opinion was initially against selling these state-owned enterprises to foreigners perhaps for
fearing of the loss of employment. This negative attitude towards foreign investment is partly responsible for the low FDI inflows at the beginning of the 1990s. This situation is not unique to Romania; it characterized all Central and Eastern European countries during the initial years of transition (Sinn and Weichenrieder 1997). As highlighted in other studies on FDI in Central and Eastern Europe (Merleverde and Schoors 2004; Aghion and Blanchard 1994), the speed of the privatization process and the methods selected are important in explaining the historical development of FDI. The findings confirm Bandelj’s (2001) theory that in transition countries, state policies rather than economic potential shaped patterns of FDI rather than economic potential.

Foreign investors’ perceptions of government willingness to reform the economy are also important. During the early transition years Romania had been governed by a center-left party with many former Communists among its leaders. These affected Romania’s credibility in the eyes of foreign investors who feared that political and economic reforms might be discontinued and even reversed. Frequent strikes during this period have also contributed to a reluctance on the part of major foreign investors to do business in Romania. The center-right government elected in 1996 (1996-2000) was more willing to privatize but frequent changes in legislation failed to boost foreign investors’ confidence in the Romanian economy. Annual inward FDI flows have increased in this period but stayed well below those of other Central and Eastern European states.

A larger increase in inward FDI flows started only after 2003, determined by a combination of two factors. Firstly, the prospect of joining NATO and the EU has
forced Romania to speed up reforms in order to harmonize its legislation with that of the EU. This had a positive effect on foreign investors as they became more confident that Romania’s economy was moving in the right direction. Secondly, while some strategic companies were privatized before 2003, the privatization of some of the most capital-intensive state-owned companies came after that date. Most of the upsurge in FDI inflows after 2003 appears to be privatization-related. There is a legitimate concern that, as most state-owned companies had been privatized by 2007 FDI may decrease in the near future. However, advantages resulting from EU membership may compensate as more greenfield investments and the acquisition of private companies by EU firms are anticipated.

The evolution of FDI in Romania illustrates the importance of path dependence as discussed by Smith and Pickles (1998) and Pavlinek and Smith (1998). Characteristics and patterns of FDI in Central and Eastern Europe during the transition years were determined by the different legacies of state socialism together with specific relations between state, economy and society (Swain and Hardy 1998: 588). Hess (2004) calls this type of dependency where foreign firms are embedded in their past trajectory “path embeddedness.”

Another conclusion that could be derived here is that in the absence of significant political and economic reforms FDI is not a solution for jump-starting economic development in a transition country. Rather than foreign investments determining economic transformation, political and economic transformation motivates foreign companies to invest in that country. Also, this research has demonstrated that there is a direct correlation between flows of inward investment
and the attitude of governments and of the local population in general towards foreign investors. As long as the general attitude was against allowing foreign capital to purchase Romanian enterprises (state-owned or newly privatized) annual inward FDI flows remained limited.

9.1.2 FDI and Macroeconomic Indicators

This study has demonstrated a very clear relationship between FDI and different macroeconomic indicators. High inflation rates characteristic of the 1990s encouraged mostly short-term speculative investments while long-term investments were postponed. Moreover, most investments, especially in the early 1990s, were in wholesale and retail industry, sectors that were neglected during Communism and which were characterized by smaller investments and immediate cash flow. Also, the low buying power of Romanians made the country of marginal interest for major market-seeking corporations. Most of the investments in this period were made by small companies and individuals. On the other hand lower and more stable inflation rates after 2003 coincide with the growing presence of foreign companies in Romania.

This study has also found a relationship between economic growth and the type of foreign direct investment. Economic recession that affected Romania between 1998 and 2002 hindered new investments while some companies left altogether. Most of the companies that invested in Romania during this period of time were efficiency-seeking, whereas the number of market-seeking companies interested in investing in Romania diminished. High growth rates since 2004
combined with rising salaries and the strengthening of the Romanian currency have encouraged the entrance of major market-seeking corporations while the country is becoming less and less attractive to efficiency-seeking companies especially in some sectors like the TCF industry.

9.1.3 Characteristics of FDI in Romania

Romania has one of the highest number of foreign investors in the world. However most of these investments are inactive and many of those that are active are small. Investments of over one million dollars, which are large enough to have a significant impact on the economy, represent less than two percent of the total number of investments. However, these large investments represent more than 91 percent of all FDI in Romania. This polarization of foreign investments into micro and large enterprises is a common characteristic for transition countries and has been reported by several other studies (Pavlinek 1998, Deichmann 1999, Buckwalter 1995). As time passes and Romania develops, the importance of medium-sized foreign investment is expected to increase.

In terms of the sectoral distribution of FDI, almost 40 percent of all foreign-owned companies are in the wholesale and retail industries. Investments in the manufacturing sector are fewer but generally larger, such that they represent about 50 percent of the FDI stock. The large number of investments in the trade sector can be explained by the fact that this sector had been neglected and chronically undersized during communism. For example, the early transition years were
characterized by shortages of consumer goods including food and clothing. Also, investments in this sector are less risky and can be started with less capital.

The relationship between transition stage and economic development on one side and the sectoral distribution of FDI on the other is also evident from the changing composition of FDI. The importance of the wholesale and retail sectors has dramatically diminished since the late 1990s both in terms of the number of companies and capital invested. At the same time, the importance of the manufacturing sector, and after 2000, the importance of the services sector has increased significantly.

9.1.4 Geographic Distribution of FDI

FDI was found to be very unevenly distributed within Romania. More than half of all foreign-owned companies and total FDI is concentrated in the capital city of Bucharest. This finding is not surprising as similar results have been found in neighboring countries.

Beyond Bucharest, foreign investors have preferred Transylvania and Banat (Northwest, West and Center Regions) while the regions outside the Carpathian Mountains (“Old Kingdom”) have attracted fewer foreign investments. In terms of capital invested, the South and Southeast leads (although they are well behind Bucharest itself). In contrast, only a small percentage of total inward FDI stock is invested in the Southwest and Northeast, regions that are predominantly agricultural. The higher amount of capital invested in the South and Southeast Regions is not necessarily an indication of foreign investor’s preference for these
regions. Most of the capital here was invested in a few very large projects following
the privatization of state-owned manufacturing enterprises. Clustering of foreign
investments in the capital and in a few other regions (especially in big cities) may
confirm Knickerbocker’s (1973) theory that many foreign investments have
happened as oligopolistic reactions to the investment of one leading company in the
same area. Also in emergent markets such as Romania clustering is a way of
minimizing risks in insufficiently-known markets.

The study found that there are also important differences in the distribution
of FDI within regions. In general, within the same region, counties with higher
levels of urbanization received more FDI that were predominantly rural. This is
hardly surprising given the fact that the more urbanized counties are also more
industrialized and represent a larger market for consumer goods and services.

Dicken et al (1997) argue that, despite the claim that distance has lost its
importance thanks to the new communication and transportation technologies, the
particularities of place continue to exert a very powerful influence on firms. Indeed,
since firms now have the ability to locate their operation(s) almost anywhere in the
world they have become more selective in choosing their place(s) of operation
(Harvey and Scott 1988).

The findings of this study indicate that physical and cultural distance remain
important in influencing the geographical dynamics of FDI. With the exception of
Bucharest, the density of foreign investments generally decreases with the distance
from the border with Hungary. This could be explained by the fact that most
investors are from Western Europe and physical distance is perhaps more important
for them than for non-European firms. In addition, the transportation infrastructure is not nearly as developed as it is in Western Europe. Therefore, foreign investors exhibit a preference for locations close to the major motorways in neighboring Hungary.

Culturally, Transylvania and Banat, which were for a long time part of the Austria-Hungary Empire are closer to Central and Western European investors than the “Old Kingdom”. This pattern, in which the west is more developed and is more attractive to foreign investors than the rest of the country is also visible in other Central European countries such as Hungary (van Hastenberg 1999), the Czech Republic (Pavlinek 1998), Poland (Deichmann 1999), and Slovakia (Pavlinek and Smith 1998).

Several other conclusions could be drawn regarding the geographical pattern of FDI. Firstly, those regions that were already more developed have attracted more FDI and/or more foreign investors, significantly widening the development gap between regions. This supports the view that FDI is rarely a panacea for all economic problems in a country. Foreign direct investment is desired because it is believed to stimulate economic growth (Carkovic and Levine 2002). While that claim is subject to some dispute, if we accept it then attracting foreign investments to less developed regions could solve numerous economic and social problems in Central and Eastern Europe.

The reasons associated with the backwardness of a region could also constitute a deterrent for FDI. FDI is not foreign aid: its motivation is profit and
therefore it tends to gravitate to those places that ensure the highest returns on investments.

While the capital city and Western Romania (especially the city of Timisoara) have become more prosperous, the historically poorer regions such as the Northeast and the Southwest are plunging deeper into economic recession. Higher unemployment rates, out-migration and low levels of investment (both domestic and foreign) characterize these predominantly agricultural regions. As Bajzikova and Svobodova (1999: 553) argue: “It is not enough to attract FDI on a global scale, it must be attracted to the right sectors of the economy and to the right regions.” However, so far all attempts to direct foreign investment to poorer regions in Romania have failed. In 1998, Romania designated several “disadvantaged areas” marked by high unemployment levels resulting from the closure of unprofitable mines and industrial plants. Foreign companies were offered attractive financial packages (including tax holidays for several years) to invest in those areas and employ local labor (Turnock 2001). These incentives have attracted almost 1,000 companies, creating 54,000 jobs (Timofticiuc 2003). However, very few of these companies were foreign-owned or joint ventures (Timofticiuc 2003). Rather the financial and tax incentives were used by many local firms who relocated their headquarters or established import-export companies in these regions in order to evade tax without actually building any production facilities (Solomon 2004). Recognizing the failure of the initial plan, the government decided in 2004 to finally eliminate the incentives for investing in “disadvantaged areas”.

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9.1.5 Foreign Investors and FDI Patterns

This study lends support to the theory that foreign companies are embedded in and reflect conditions from their home countries (Dicken 2003). A number of characteristics of foreign investments related to the average size of investment, mode of investment (greenfield or acquisition), structure of ownership (fully-owned or joint venture) and specialization in certain economic activities differ based on the country of origin reflecting characteristics from the economic, political, cultural and social environment of the home country.

Some of these characteristics, however, are determined by other factors like the physical and cultural distance discussed earlier. Foreign firms from countries that are situated closer to Romania are more numerous whereas those from countries that are farther away (geographically and culturally) are much larger in terms of their investment but less numerous. Many Hungarians, Germans, Italians and Turks were familiar with the Romanian market and due to low entry requirements many individuals and small companies from these countries have invested in Romania. On the other hand, investors from countries that are physically and culturally distant have less information about Romania and only the larger companies have the interest and resources to study the market.

Cultural factors are also seen as important. Foreign investors tend to prefer those counties inhabited by their co-nationals. This study finds a very strong direct spatial correlation between Hungarian investments and Hungarian minority population and similarly strong correlations for German and Greek investments (with German and Greek minority populations respectively). In addition, some of
the counties with the highest Turkish FDI are those that have a significant Turkish minority population.

9.1.6 Determinants of FDI

The study has shown that most investors in both the automotive and the textile industries are efficiency-seeking rather than market seeking. Low operating costs (and especially low labor costs) and the presence of highly educated and skilled labor are the most important factors in attracting FDI. However, finding qualified labor is becoming increasingly difficult in both industries as many Romanians have sought work in Western Europe and work there. This, in turn, has put pressure on wages. Since accession, Romania is one of the EU countries with the highest wage increases. Wage differentials between Romania and Western Europe are still sufficient to justify outsourcing but in industries which are more cost-sensitive the interest of foreign investors in Romania appears to be fading. One such industry is the TCF industry where competition from East Asia after the end of the quota system has become more intense. As most investors in the two industries discusses in this study (the automotive industry and the TCF industry) are from the European Union it is not surprising that proximity to the EU is considered significant for both industries, which is a more general characteristic of efficiency-seeking investments.

The idea that FDI in the two manufacturing sectors is efficiency-seeking is supported by the finding that the size, strength and potential of local and national markets show very limited importance for foreign investors. Also, unlike in other
Central and Eastern European countries (Thompson 2000; Bartlett and Seleny 1998) financial incentives appear to be less important for foreign investors in Romania.

While there are many general similarities between the two manufacturing sectors in terms of the determinants of FDI, there are also a number of important differences. Proximity to partners (suppliers or customers) already in Romania and cultural similarities (language, religion, etc.), as well as government policies and incentives, seem to be more important for the TFC sector than for the automotive sector. The main reason for these differences is that firms in the TFC sector are much smaller and depend more on personal relationships and networking. Another significant difference is that proximity to other countries in Eastern Europe is more important for the automotive industry than for the TCF industry. Many automotive investments in western Romania are linked to car factories in the Czech Republic, Slovakia, Poland and Hungary within the automotive cluster known by some “Detroit East”.

The differences between the two industries are more significant when it comes to site selection. For the automotive industry, proximity to international markets seems to be more important, hence the concentration of foreign investments in the western half of the country. On the other hand, foreign investments in the TCF industry are more evenly distributed. The concentration of the automotive industry in the west could be attributed to the existence of the automotive cluster in central Europe and the need for just-in-time production in this industry. This type of production system and the need to stay close to customers and suppliers also dictates that automotive plants be proximate to major transportation links. Foreign
investors in the TCF sector, while still trying to maintain a reasonable distance from their partners in Western Europe, are more sensitive to operation costs. Accordingly, they are more willing to invest in areas that are farther away or more isolated if the conditions are right.

Differences in average size between the two industries determine how investors view the importance of previous relationship with local companies. Linkages with other companies in the region and local authorities’ attitudes to foreign investments are rated differently by investors from the two sectors. TCF factories, being smaller and having lesser impact on the local economy and community can rarely attract any help from the local governments. In contrast it is much more important for larger automotive plants to have a good relationship with local authorities.

The main hindrances for foreign investment in both industries are the frequently changing legislation combined with bureaucracy and corruption. This was found to be the main problem in most developing and transition countries, particularly in Southeastern Europe (Bitzenis 2003). Other studies have also found that the existence of a rule of law and of a clear legislation is more important for foreign investors than any financial or fiscal incentive (McGee 2003). Another problem shared by respondents in both industries is the shortage of qualified labor combined with low intra-national mobility and a generally poor work ethics. Moreover, labor legislation in Romania tends to favor the employee over the employer. Under these conditions, finding good workers for low wages is becoming
more difficult. However, as foreign investors indicate these problems are not yet serious enough to keep foreign companies from investing in Romania.

9.1.7 Impact of FDI on Local Economies

Foreign investments in both the industries studied appear to be rather poorly embedded. They source very few materials from Romania and export most of their production. However the reasons behind this situation are somewhat different for each industry despite their shared reliance upon cheap and qualified labor.

In the automotive sector, foreign investors continue to rely on their traditional suppliers from abroad because many material supplies are simply not produced by Romanian companies. When they are available, Romanian-made components are commonly of lower quality and often more expensive than imported equivalents. In this case, the lack of embeddedness may not reflect so much the choice of foreign companies as it may be due to a lack of local alternatives for suppliers (Meyer 1998).

Furthermore, since many of these ties are based on trust, which only develops in time (Uzzi 1997), the conclusions of this study need to be seen from a temporal or “path dependence” perspective (Halinen and Tornroos 1998). It seems unlikely, however, that many Romanian companies will become suppliers of multinational corporations. The strategy of these multinational investors has been to instruct their traditional suppliers to follow them and invest in Romania rather than to help Romanian suppliers to become more competitive. Unlike the case with Skoda’s suppliers in the Czech Republic (after the acquisition by Volkswagen) there
is little evidence that multinationals’ traditional suppliers have been encouraged to form joint ventures with Romanian.

Also, while some traditional suppliers to Renault have invested in Romania specifically to manufacture parts for Dacia, most of the foreign automotive companies in Romania are producing for export, especially those situated in the western part of the country. However, an increasing number of these export-oriented factories are also signing contracts with the two Romanian automakers and many Dacia suppliers are also producing for other assembly plants owned by the Renault-Nissan alliance.

To summarize, in the case of foreign direct investments in the automotive industry local embeddedness is limited. Instead foreign automotive companies in Western Romania are regionally (i.e. supra-nationally) embedded in the Central European automotive cluster. Foreign automotive companies in Romania are also embedded in the automakers’ worldwide network of suppliers and customers, evidence of what Hess (2004) calls “network embeddedness”.

Foreign direct investments in the TCF sector are also characterized by very few linkages with Romanian companies. In this case, the lack of embeddedness reflects the importance of two trade agreements: the Multi-Fiber Arrangement (MFA) and the Outward Processing Trade (OPT) agreement. The MFA restricted the presence of Asian TCF products in the Western European market while the OPT program has opened the door for Eastern European products provided they use raw materials from Western Europe. In order to save on labor costs, many Western European TCF companies have transferred production to Eastern Europe. The two
trade agreements not only made the Western European TCF companies more competitive on the international market by reducing their production costs but also saved the Eastern European TCF industry from collapse following the fall of the COMECOM market.

The OPT relationships, however, created a very spatially dis-embedded situation for foreign-owned TCF companies. In Romania this has resulted in the destruction of the textile industry. Most clothing manufacturers were obligated by the OPT agreement to use imported materials while Romanian textile were not competitive on the international market. Some degree of spatial embeddedness was achieved, however, due to the fact that many of these foreign companies preferred to subcontract different phases of the production process to local companies. Some scholars have even argued that in certain areas industrial district-type clusters have developed replicating industrial districts in Italy and other European countries. Foreign-owned TCF companies in Romania are also embedded globally in the network of suppliers and customers of their parent company.

The problems confronting the Romanian TCF sector after the end of the quota system and after the end of the OPT agreement illustrate the dangers associated with over-dependence on poorly embedded foreign direct investment (Pavlinek 2002a, 2004; Hamar 1999; Mejstrik 1995; Benacek 2000; Hunya 2000; Kapoor 2000; and Misun and Tomsik 2001). Without the protection of the two trade agreements, Romanian-made products have found it more difficult to compete on the Western European markets with cheaper products made in Asia. After years of neglect, Romanian-based TCF manufacturers have also lost the domestic market as
well to cheaper imports from Asia. Moreover very few TCF companies still have R & D capabilities meaning that they cannot exist independently of the support of their western partner(s).

9.2 Implications of this Research

Most research on FDI in Central and Eastern Europe focuses on the more developed countries such as the Czech Republic (Mejstrik 1995; Pavlinek 1998; Pavlinek and Smith 1998; Zemplinerova and Jarolim 2001), Poland (Jermakowicz 1995; Uminski 2001; Walkenhorst 2001; Deichmann 1999), Hungary (Csaki 1995; Mihalyi 2001; Swain 1998; Szanyi 2001; van Hastenberg 1999), Slovakia (Smith 1996; Smith and Ferencikova 1998) and Slovenia (Bandelj 2004; 2003; 2002; 2001) or countries with an enormous potential for foreign investors, notably Russia (Barski 1995; Bradshaw 2002). Romania has been largely neglected, at least by geographers. Several studies deal with FDI in the Central and Eastern European “bloc” (Deichmann 2001; Deichmann et al. 2003; Michalak 1993; Murphy 1992; Pye 1997; Turnock 2001a; Simai 1998) or in Southeast Europe (Gligorov 2001; Hunya 2004a; 2002a; 2000; McGee 2003) and make reference, in some cases extensive, to Romania. There is, however, no comprehensive geographical study of FDI in Romania. A few studies have been conducted by English-speaking economists (Voinea 2002; Voicu 2000; Radulescu 1996; Hunya 2002b), but most are available only in Romanian (Bogdan and Platon 1981; Andronic 1999; Anghel 2002; Denuta 1997; Ionita 1999; Matei 2004; Munteanu 1995; Negritoiu 1996,
1995; Popescu 1998; Guran-Nica 2002). None of these studies have paid explicit attention to the geographical dynamics of FDI.

9.2.1 Implications for the theory

Many of the findings presented in this work fit within the theories that constitute the framework of the study. These theories of FDI that were developed in the context of Western countries are also verified in Romania in the context of a restructuring economy. A few characteristics of FDI in Romania are also conforming to theories of FDI in developing countries. For example clustering of FDI in one area, usually the capital or a region with important mineral resources is a situation characteristic mainly to developing countries. In Romania, as in other Central and Eastern European countries, over half of all foreign companies and over half of all FDI is concentrated in the capital. This lends to the idea that, when the market is relatively unknown or risky to foreign investors, they tend to cluster together in order to minimize the uncertainties.

Although major theories of FDI are generally applicable to Central and Eastern Europe, due to their path dependence, these Central and Eastern European countries, and particularly Romania, show characteristics that sometimes deviate from mainstream theory. Theories of foreign direct investment are based on and have evolved with the changes that have affected capitalist economies in the West, especially as neo-liberal theories became more entrenched and as economies changed and become more globalized. Central and Eastern European economies have skipped several phases of capitalist evolution. They had to deal with a legacy
of state socialism which has left a significant impact not only on the economy but also on people’s attitudes towards and on people’s perception of capitalism. Also, there is a very close relationship between the geographical dynamics of FDI and the speed and method of privatization selected in each country as well as general progress towards a market economy. The process of integration into the Euro-Atlantic has also had a strong impact on the dynamics and spatial distribution of FDI in the Central and Eastern European economies. Another specific characteristic of FDI in Romania and in other countries in Central and Eastern Europe is that it tends to cluster in the more developed regions thus amplifying existing inequalities.

9.2.2 Policy Recommendations

The study also has important policy implications. Appropriate policies to either encourage or discourage FDI or to solicit foreign investments of a certain type are likely to follow based on its results. In understanding the determinants of foreign investments in Romania, authorities at the national and local level will be better placed to work together to maximize the effects of FDI. Based on the needs of foreign investors and the expectations of local communities, authorities can seek to match investors with communities and regions. An understanding of the geographical dynamics of FDI may also allow for policies that might successfully steer FDI towards certain disadvantaged regions with high unemployment rates or negative growth rates.

Based on the results from this study, a number of policy recommendations arise. First, the major problems identified by foreign investors need to be addressed
and corrected. Most foreign investors complain about frequently changing legislation. Foreign investors require stable laws in order to be able to make long term investment plans. This study has shown that more than fiscal incentives, foreign investors need legislative stability. This problem of frequently changing legislation is likely to disappear in time even without the government’s direct intervention as, after accession, Romania has had to adopt EU legislation. This will make the investing climate not only more predictable but also more familiar for investors from the EU countries (which represent the majority of foreign investors) reducing the psychic distance that separates their home countries from Romania.

The second problem that needs to be addressed is the critical labor in certain economic sectors. Romania inherited a large cohort of qualified labor from the previous regime which made the country attractive for the outsourcing operations of foreign companies. However, after 2002 Romanians were allowed to travel freely within the Schengen countries. Due to very high wage differential many Romanians elected to find jobs in these countries. At the same time Romania is confronted with a chronic labor deficit. Finding qualified labor is becoming increasingly difficult. Under these conditions attracting more foreign investors into the manufacturing sector is beginning to prove problematic. The Romanian government is aware of the situation and frequently references the need to design a strategy for the return of Romanians working in other EU countries. This could only happen if wages in Romania increase to quasi-Western European levels. However, this would undermine Romania’s attractiveness to foreign investors. Another solution would be to import labor from countries like China, India or Bangladesh. Already some
companies are functioning with imported labor but the legislation is complicated and discourages others from following suit.

9.3 What Next?

Due to time and resource constraints, only two manufacturing sectors were considered for the study of determinants and impact of FDI in Romania. While these two sectors were selected carefully in order to offer a wider array of possible findings, the results of the study are still somewhat limited and not representative for the entire Romanian economy. The study showed that most foreign companies have invested in Romania in order to take advantage of cheap labor while market expansion reasons were found to be minimal. However, not all manufacturing sectors are geared towards export production. It is possible that a similar study on FDI in the food industry may bring very different results. Moreover, the largest number of foreign investments is in the retail and wholesale trade sectors where some of the largest global chains are vying for market share in Romania. Also the fastest growth in FDI flows and the highest M & A deals were recorded in the service sector. I suspect that the determinants for FDI and the level of embeddedness in these sectors are very different from the two manufacturing sectors studied.

In the future, the study would benefit considerably from broadening the scope of the research. Other economic sectors constitute potential topics for research in the near future. My plan for the next five years is to systematically study the characteristics and pattern of FDI in industries such as food processing, furniture,
construction materials, retail, banking and real estate. When completed, the study would provide a more complete image of the main characteristics of FDI in Romania.

More research is needed in other transition countries in order to understand the influence of Communism and economic transition on the dynamics of FDI. How do characteristics and pattern of FDI in Romania compare with the situation in other Central and Eastern European countries? Could this research be replicated in other countries that are in a more incipient phase of transition? How may the results differ and why? And, can other developing or transition countries learn from Romania’s experience?

Also, a second study spaced at five or ten years may be useful to capture changes in the characteristics and pattern of FDI in Romania following accession to the EU. At the time of this research, the influence of the EU on inward FDI flows was very strong but mostly at a speculative level, meaning that at that time the effects of EU membership were only anticipated. The real effects of EU on FDI flows could only be assessed after several years of membership. One of the potential changes may be reflected in our approach to the distribution of FDI in Romania which will have to be analyzed in the EU or, at least in the regional context (including all member countries in Central Europe) rather than at national levels.
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10/12/2005


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APPENDICES
Appendix A

Foreign-Owned Automotive Plants in Romania
<table>
<thead>
<tr>
<th>Foreign Company</th>
<th>Country of Origin</th>
<th>Location of investment</th>
<th>Form of investment</th>
<th>Capital invested or pledged to be invested</th>
<th>What produces?</th>
</tr>
</thead>
<tbody>
<tr>
<td>ACE</td>
<td>Spain (ACE was recently acquired by Fujikura from Japan)</td>
<td>Cluj-Napoca (NW) and Dej Cluj County- in construction</td>
<td>greenfield</td>
<td></td>
<td>Wirings</td>
</tr>
<tr>
<td>Lisa Draxlmaier</td>
<td>Germany</td>
<td>Pitesti (Arges County) Hunedoara, Timisoara (both West Region), Satu Mare (NW), Brasov (Center)</td>
<td>Brownfield (Pitesti); Greenfield (all others)</td>
<td>$156 million</td>
<td>Electric components</td>
</tr>
<tr>
<td>Solectron</td>
<td>USA</td>
<td>Timisoara (West)</td>
<td>Greenfield</td>
<td>$50 million</td>
<td>Electronic devices</td>
</tr>
<tr>
<td>Dura Automotive</td>
<td>USA</td>
<td>Timisoara</td>
<td>greenfield</td>
<td>…</td>
<td>Automotive components (Door Frames &amp; Components, Glass Encapsulations, Manual Gear Shift Systems, Traditional Park Brake Systems)</td>
</tr>
<tr>
<td>Foreign Company</td>
<td>Country of Origin</td>
<td>Location of investment</td>
<td>Form of investment</td>
<td>Capital invested or pledged to be invested</td>
<td>What produces?</td>
</tr>
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</tr>
<tr>
<td>Coficab (in construction)</td>
<td>Tunisia</td>
<td>Timisoara</td>
<td>greenfield</td>
<td>$32 million</td>
<td>wirings</td>
</tr>
<tr>
<td>Sumitomo Electric Wiring System</td>
<td>Japan</td>
<td>Deva Orastie (both West Region) Alba Iulia (Center Region)</td>
<td>greenfield</td>
<td>…</td>
<td>wirings</td>
</tr>
<tr>
<td>Yazaki</td>
<td>Japan</td>
<td>Ploiesti (South Region) + Arad (West)</td>
<td>greenfield</td>
<td>$13 million</td>
<td>Wirings</td>
</tr>
<tr>
<td>Alcoa-Fujicura</td>
<td>USA/Japan</td>
<td>Caransebes and Chisineu-Cris (both West Region) + Beius (NW)</td>
<td>greenfield</td>
<td>$5 million</td>
<td>Integrated electrical distribution systems, wiring harness assembly</td>
</tr>
<tr>
<td>SNR Roulements</td>
<td>France</td>
<td>Sibiu (Central Region)</td>
<td>greenfield</td>
<td>…</td>
<td>Ball bearings</td>
</tr>
<tr>
<td>INA Schaffler</td>
<td>Germany</td>
<td>Brasov County-Center</td>
<td>greenfield</td>
<td>$236 million (+$125 million planned for the next years)</td>
<td>Ball bearings</td>
</tr>
<tr>
<td><strong>Foreign Company</strong></td>
<td><strong>Country of Origin</strong></td>
<td><strong>Location of investment</strong></td>
<td><strong>Form of investment</strong></td>
<td><strong>Capital invested or pledged to be invested</strong></td>
<td><strong>What produces?</strong></td>
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<td>-------------------</td>
</tr>
<tr>
<td>Continental</td>
<td>Germany</td>
<td>Timisoara (W Region); Sibiu (Central Region), Carei (NW)- a total of 5 plants</td>
<td>Brownfield (Timisoara); Greenfield (Sibiu)</td>
<td>$131 million (over $250 million together with ContiTech)</td>
<td>Tires, transmission belts, electronic components for belts</td>
</tr>
<tr>
<td>Michelin</td>
<td>France</td>
<td>Zalau (NW Region); Floresti, near Bucharest</td>
<td>Acquisition</td>
<td>$180 million</td>
<td>Tires</td>
</tr>
<tr>
<td>Cord Romania</td>
<td>Italy</td>
<td>Slatina (Southwest Region)</td>
<td>Greenfield joint venture between Pirelli (80%) and Continental (20%)</td>
<td>$52 million</td>
<td>Tires</td>
</tr>
<tr>
<td>Johnson Controls</td>
<td>USA</td>
<td>Ploiesti + Pitesti (South Region)</td>
<td>Greenfield</td>
<td>$63 million</td>
<td>Upholstery</td>
</tr>
<tr>
<td>Coindu (in construction)</td>
<td>Portugal</td>
<td>Curtici-Arad (West Region)</td>
<td>Greenfield</td>
<td>$40 million</td>
<td>Upholstery</td>
</tr>
<tr>
<td>Momo</td>
<td>Italy</td>
<td>Brad-Hunedoara County (West Region)</td>
<td>Greenfield</td>
<td>...</td>
<td>Steering wheels</td>
</tr>
<tr>
<td>Foreign Company</td>
<td>Country of Origin</td>
<td>Location of investment</td>
<td>Form of investment</td>
<td>Capital invested or pledged to be invested</td>
<td>What produces?</td>
</tr>
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<td>-------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Takata-Petri</td>
<td>Japan</td>
<td>Arad (West Region) Sibiu (Center) – in construction</td>
<td>Greenfield</td>
<td>$53 million</td>
<td>Steering wheels (Arad) Passenger airbags (in Sibiu)</td>
</tr>
<tr>
<td>Phoenix Automotive</td>
<td>U.K.</td>
<td>Carei (NW Region)</td>
<td>Greenfield</td>
<td>$120 million</td>
<td>Rubber parts for cars</td>
</tr>
<tr>
<td>Autoliv Romania</td>
<td>Sweden</td>
<td>Brasov (Center); Pitești (South) + Timișoara (new, R &amp; D)</td>
<td>Greenfield (Pitești) and Joint Venture (Brasov)</td>
<td>Automated safety systems</td>
<td></td>
</tr>
<tr>
<td>Alcatel Romania</td>
<td>France</td>
<td>Arad County (West Region)</td>
<td>Greenfield</td>
<td></td>
<td>Cables</td>
</tr>
<tr>
<td>Ruwel</td>
<td>Germany</td>
<td>Cluj Napoca (NW Region)</td>
<td>Greenfield</td>
<td>$105 million</td>
<td>Printed circuit board</td>
</tr>
<tr>
<td>Thyssen Krupp A.G.</td>
<td>Germany</td>
<td>Galati (SE Region) and Sibiu (Center)</td>
<td>Joint Venture</td>
<td>$30 million</td>
<td>Shock absorber capacities and various other steel components</td>
</tr>
<tr>
<td>Leoni A.G.</td>
<td>Germany</td>
<td>Bistrita (NW Region) and Arad (West Region)</td>
<td>Greenfield</td>
<td>$130 million</td>
<td>Electronic cables</td>
</tr>
<tr>
<td>Foreign Company</td>
<td>Country of Origin</td>
<td>Location of investment</td>
<td>Form of investment</td>
<td>Capital invested or pledged to be invested</td>
<td>What produces?</td>
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</tr>
<tr>
<td>Valeo</td>
<td>France</td>
<td>Mioveni-Pitesti (South Region)</td>
<td>Greenfield</td>
<td></td>
<td>Wiring harnesses, radiators, heating and ventilation, air conditioning, etc.</td>
</tr>
<tr>
<td>Auto Chassis International</td>
<td>France</td>
<td>Mioveni (South)</td>
<td>Greenfield</td>
<td>$88 million</td>
<td>Chassis, other auto parts</td>
</tr>
<tr>
<td>Siemens</td>
<td>Germany</td>
<td>Timisoara (West) + Iasi (NE)</td>
<td>Greenfield</td>
<td></td>
<td>Automotive software</td>
</tr>
<tr>
<td>Faurecia</td>
<td>France</td>
<td>Talmaciu-Sibiu (Center)</td>
<td>Greenfield</td>
<td></td>
<td>Door panels, instrument panel, upholstery.</td>
</tr>
<tr>
<td>Lear Corporation</td>
<td>USA</td>
<td>Pitesti (South)</td>
<td>Greenfield</td>
<td></td>
<td>Automotive interior systems</td>
</tr>
<tr>
<td>Baumeister &amp; Oustler</td>
<td>Germany</td>
<td>Arad (West)</td>
<td>Greenfield</td>
<td>$21.5 million</td>
<td>Aluminum and rubber components</td>
</tr>
<tr>
<td>Star Transmission working for Daimler-Chrysler</td>
<td>Germany-USA</td>
<td>Cugir (Center)</td>
<td>Joint Venture</td>
<td></td>
<td>Gear boxes</td>
</tr>
<tr>
<td>Foreign Company</td>
<td>Country of Origin</td>
<td>Location of investment</td>
<td>Form of investment</td>
<td>Capital invested or pledged to be invested</td>
<td>What produces?</td>
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<tr>
<td>Delphi Packard</td>
<td>USA</td>
<td>Sannicolau Mare (West)</td>
<td>Greenfield</td>
<td></td>
<td>Cables</td>
</tr>
<tr>
<td>Eybl International A.G.</td>
<td>Austria</td>
<td>Timisoara + Deta (West)</td>
<td>Greenfield</td>
<td></td>
<td>Steering wheels + Upholstery</td>
</tr>
<tr>
<td>Honeywell Garrett</td>
<td>USA</td>
<td>Bucharest</td>
<td>Brownfield</td>
<td></td>
<td>Components for turbo engines</td>
</tr>
<tr>
<td>Kromberg &amp; Schubert</td>
<td>Germany</td>
<td>Timisoara (West)</td>
<td>Greenfield</td>
<td></td>
<td>Cables</td>
</tr>
<tr>
<td>Koyo Seiko</td>
<td>Japan</td>
<td>Alexandria (South)</td>
<td>Privatization</td>
<td></td>
<td>Ball bearings</td>
</tr>
<tr>
<td>Magneto Group</td>
<td>Italy</td>
<td>Dragasani (South)</td>
<td>Privatization</td>
<td>$5 million</td>
<td>Wheels</td>
</tr>
<tr>
<td>Solvay-INERGY</td>
<td>Belgium</td>
<td>Pitesti</td>
<td>Brownfield</td>
<td></td>
<td>Various components</td>
</tr>
<tr>
<td>ContiTech (part of Continental)</td>
<td>Germany</td>
<td>Timisoara</td>
<td>greenfield</td>
<td></td>
<td>Transmission belts and rubber hoses for air conditioning</td>
</tr>
<tr>
<td>Hella (in construction)</td>
<td>Germany</td>
<td>Timisoara, Lugoj and Sanicolau Mare (all West)</td>
<td>greenfield</td>
<td>$12-13 Million (Timisoara)</td>
<td>Light bulbs for cars</td>
</tr>
<tr>
<td>Renault-Nissan (in construction)</td>
<td>France</td>
<td>Pitesti</td>
<td>greenfield</td>
<td></td>
<td>Gearboxes</td>
</tr>
<tr>
<td>Foreign Company</td>
<td>Country of Origin</td>
<td>Location of investment</td>
<td>Form of investment</td>
<td>Capital invested or pledged to be invested</td>
<td>What produces?</td>
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</tr>
<tr>
<td>Schlemmer</td>
<td>Germany</td>
<td>Satu Mare (NW)</td>
<td>greenfield</td>
<td>$12-13 million</td>
<td>Wirings</td>
</tr>
<tr>
<td>(in construction)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TRW (in construction)</td>
<td>USA</td>
<td>Timisoara</td>
<td>greenfield</td>
<td></td>
<td>Steering wheels</td>
</tr>
<tr>
<td>Weidmuller</td>
<td>Germany</td>
<td>Tautii Magheraus (near Baia Mare- NW)</td>
<td>greenfield</td>
<td></td>
<td>Electric components</td>
</tr>
<tr>
<td>(in construction)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Marquardt</td>
<td>Germany</td>
<td>Sibiu</td>
<td>greenfield</td>
<td>$10 million (+ another 19 million by 2008)</td>
<td>Electronic components</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Caucho Metal Productos</td>
<td>Spain</td>
<td>Sibiu</td>
<td>greenfield</td>
<td>$12-13 million</td>
<td>Components made of rubber and metals</td>
</tr>
<tr>
<td>(in construction)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Manufactura Moderna de Metales</td>
<td>Spain</td>
<td>Turda</td>
<td>greenfield</td>
<td>$12-13 million</td>
<td>Tubular components for the automotive industry</td>
</tr>
<tr>
<td>(in construction)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Trelleborg</td>
<td>Sweden</td>
<td>Dej</td>
<td>greenfield</td>
<td>$12-13 million</td>
<td>Anti-vibration products</td>
</tr>
<tr>
<td>(in construction)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Calsonic Kansai (in negotiation with local authorities)</td>
<td>Japan</td>
<td>Ploiesti</td>
<td>greenfield</td>
<td>$29 million in the first stage; up to $126 million</td>
<td>Dashboards</td>
</tr>
<tr>
<td>Gurit- Essex</td>
<td>Switzerland</td>
<td>Pitesti</td>
<td>Joint venture</td>
<td></td>
<td>Adhesives for the auto industry</td>
</tr>
<tr>
<td>(Gurit- Essex was acquired by Dow Automotive from USA)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Company</td>
<td>Country of Origin</td>
<td>Location of investment</td>
<td>Form of investment</td>
<td>Capital invested or pledged to be invested</td>
<td>What produces?</td>
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</tr>
<tr>
<td>Eckerle (in construction)</td>
<td>Germany</td>
<td>Cluj-Napoca</td>
<td>greenfield</td>
<td>$3 million in a first phase to build a greenfield plant</td>
<td></td>
</tr>
<tr>
<td>S.I.L. MET (in construction)</td>
<td>Italy</td>
<td>Pecica (Arad)</td>
<td>greenfield</td>
<td>$5 million</td>
<td></td>
</tr>
<tr>
<td>Stabilus (new)</td>
<td>Germany</td>
<td>Brasov</td>
<td>greenfield</td>
<td>$12-13 million</td>
<td>Ergonomic chairs</td>
</tr>
<tr>
<td>Ert (in construction)</td>
<td>Portugal</td>
<td>Curtici, Arad</td>
<td>greenfield</td>
<td>$6 million initially, then up to $19 million (2006-2008)</td>
<td>Polyurethane foam for Coindu</td>
</tr>
<tr>
<td>Kuhnke</td>
<td>Germany</td>
<td>Sibiu</td>
<td>greenfield</td>
<td></td>
<td>Relays, pneumatics and solenoids</td>
</tr>
<tr>
<td>Plastique Forme</td>
<td>France</td>
<td>Timisoara</td>
<td>greenfield</td>
<td>$4 million</td>
<td></td>
</tr>
<tr>
<td>Nexans</td>
<td>France</td>
<td>Chisineu-Cris (Arad County)</td>
<td>greenfield</td>
<td>$4 million</td>
<td>wirings</td>
</tr>
<tr>
<td>Freudenberg</td>
<td>Germany</td>
<td>Ploiesti</td>
<td>greenfield</td>
<td></td>
<td>Brake equipments</td>
</tr>
<tr>
<td>Bosch (planned)</td>
<td>Germany</td>
<td>Blaj (Alba)</td>
<td>Joint venture</td>
<td>$13-14 million</td>
<td>High precision equipment for automation</td>
</tr>
<tr>
<td>Foreign Company</td>
<td>Country of Origin</td>
<td>Location of investment</td>
<td>Form of investment</td>
<td>Capital invested or pledged to be invested</td>
<td>What produces?</td>
</tr>
<tr>
<td>-----------------</td>
<td>-------------------</td>
<td>------------------------</td>
<td>--------------------</td>
<td>------------------------------------------</td>
<td>----------------</td>
</tr>
<tr>
<td>Brose (evaluating possible investment and negotiating with local authorities)</td>
<td>Germany</td>
<td>Arad</td>
<td>greenfield</td>
<td>$50 million</td>
<td></td>
</tr>
<tr>
<td>Webasto (direct supplier of Brose)</td>
<td>Germany</td>
<td>Arad</td>
<td>Greenfield</td>
<td>$12-13 million</td>
<td></td>
</tr>
<tr>
<td>Cabot Corporation (decided to invest in Romania; currently evaluating different sites)</td>
<td>USA</td>
<td>Prahova or Arges Counties</td>
<td>Greenfield</td>
<td>$100 million</td>
<td>Carbon black used for the production of tires and for other automotive components</td>
</tr>
<tr>
<td>Arcelor + Bamesa (intend to invest)</td>
<td>European conglomerate + Spain</td>
<td>Topoloveni (Arges)</td>
<td>Greenfield</td>
<td>$38 million</td>
<td>Center for ferrous metallurgy services</td>
</tr>
<tr>
<td>CIE Berriz (in the process of acquiring Matricon Mures)</td>
<td>Spain</td>
<td>Targu Mures</td>
<td>acquisition</td>
<td>4 million euros for the acquisition</td>
<td>Auto parts</td>
</tr>
</tbody>
</table>

Appendix B

Questionnaire
The Determinants of FDI in Romania and the Local Embeddedness of FDI

Please, take a few moments to answer the following questions. Your answers are very important for my study and should take no more than 20 minutes of your time.

Section A asks questions about investing in Romania, the different regions of Romania and about investing in the particular local economy in which your firm is located

1. Why did the company choose Romania for its investment? Please, select all the factors that apply. Use numbers to indicate importance by checking the relevant box (1 = not important; 2 = somewhat important; 3 = important; 4 = very important).

<table>
<thead>
<tr>
<th>Factor</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market size (population)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market strength (spending power)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market potential</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Proximity to EU</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proximity to Russia and other former Soviet Union republics</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proximity to other countries in Eastern Europe</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low operating costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Low labor costs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Skilled labor</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Raw materials</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proximity to partner, supplier or customer, already in Romania</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Romanian government investment policies and incentives</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political stability</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Owner, CEO or other executive is of Romanian decent or has family in Romania</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other cultural affinities: language, religion, etc.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other (please describe below)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

2. What other countries, besides Romania, did the company consider at the time of this investment?

________________________________________________________
________________________________________________________

___.
3. What hindrances do you see in attracting foreign investors to Romania?

4. What other regions of Romania besides this one did the company consider for investment?
5. Why did you invest in this town/county? Please, select all that apply. Use numbers to indicate importance by checking the relevant box (1 = not important; 2 = somewhat important; 3 = important; 4 = very important).

<table>
<thead>
<tr>
<th>Factor</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Existing linkages with (a) Romanian company or companies in the region</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local authorities positive attitude to foreign investment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Local authority incentives</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Suppliers, customers or competitors have located here previously</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Land availability</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proximity to major markets</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Communication/transport links</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Quality of life (cultural amenities)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Proximity to markets/customers beyond Romania</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cultural similarities to the country and region of origin (language, religion, work ethic etc)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6. What other towns and counties did you consider at the time of this investment?

________________________________________________________
________________________________________________________

Section B asks questions about the geography of supply linkages and sales (including both sales to consumers as well as sales to other firms). Some questions pertain to the last twelve months while others ask you to estimate similar figures for the company’s first year of operation at this site.

7. Estimate the percentage of your material supplies over the past twelve months (by value) that were sourced from the following

<table>
<thead>
<tr>
<th>Source</th>
<th>Current Percentage</th>
<th>Percentage in the first year of operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local economy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regional economy (based on the eight Economic Development regions)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Romania</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Home Country</td>
<td></td>
<td></td>
</tr>
<tr>
<td>European Union</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

8. Of the material inputs sourced from within the local economy please estimate the share of all local inputs that are provided by other foreign investors rather than Romanian owned companies?

________________________________________________________%
9. Estimate the percentage of material inputs, by value, obtained from elsewhere within the companies “parent group”: ____________%.

10. For the main material inputs which are not obtained from within the local economy, which of the following reasons best explain this plant’s decision to use non-local suppliers:

   a. The material inputs are not available from suppliers within the local economy
   b. The material inputs are available from suppliers within the local economy but they are of inadequate quality
   c. The material inputs are available from suppliers within the local economy region but they are too costly
   d. We have an established relationship with a supplier from outside the local economy who we prefer to use
   e. Our head office or parent company directs us to use certain suppliers from outside the local economy
   f. Other reasons → please specify.

11. Roughly what percentage of your products (by value) do you sell to other firms rather than to final consumers? 
   _____________________%.

12. What percentage of your products (based on annual revenues) do you sell to customers in each of the following?

<table>
<thead>
<tr>
<th>Current Percentage</th>
<th>Percentage in the first year of operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local economy</td>
<td></td>
</tr>
<tr>
<td>Regional economy (based on the eight Economic Development regions)</td>
<td></td>
</tr>
<tr>
<td>Romania</td>
<td></td>
</tr>
<tr>
<td>Home Country</td>
<td></td>
</tr>
<tr>
<td>European Union</td>
<td></td>
</tr>
<tr>
<td>Other (foreign)</td>
<td></td>
</tr>
</tbody>
</table>

13. Could you estimate the percentage of this plant’s total outputs, by value, that go to other parts of the parent group: ____________
14. What percentage of the services used by this firm (based on annual expenditure) is provided by companies in each of the following?

<table>
<thead>
<tr>
<th>Service Description</th>
<th>Current Percentage</th>
<th>Percentage in the first year of operation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local economy</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Regional economy (based on the eight Economic Development regions)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Romania</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Home Country</td>
<td></td>
<td></td>
</tr>
<tr>
<td>European Union</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other (foreign)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

15. Do you sponsor cultural events, sports competitions or teams, school activities or any other activities organized at local level?
   Yes; No.

16. If you answered yes at question15, roughly how much did you spend on these activities over the last twelve months?
    ________________.

17. Please indicate the level at which the following decisions are made.
   1. Indicates decisions are taken at plant level/ on a day-to-day basis;
   2. indicates decisions are usually taken at plant level but must be approved by head-office while 3. indicates that decisions are taken at the head office of parent group

<table>
<thead>
<tr>
<th>Decision Description</th>
<th>Plant level decision</th>
<th>Head office decision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales promotion activities</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Product &amp; packaging design / styling</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Market territory served by this plant</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Setting product price levels</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Purchasing materials/ components</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Selection of subcontractors</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Awarding contracts for services</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Organizing work flows</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Deciding on material stock levels</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Raising short-term finance</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Major capital investments (approval)</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Purchasing production machinery</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Recruitment of senior personnel</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Staff training programs/policy</td>
<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>
Questions about the firm:

18. What is the nationality of the parent company?
   ____________________; Where is it headquartered?
   ____________________.

19. Indicate or estimate the number of countries in which the parent company has affiliates or operations: ________.

20. Please indicate the continents in which your parent company has operations (check all that apply):
    a. Western Europe;
    b. North America;
    c. Latin America;
    d. Eastern and Southeastern Asia;
    e. Other parts of Asia;
    f. Africa;
    g. Australia and Oceania

21. Does the parent company have operations in any of the following Eastern European countries (check all that apply)
    a. Baltic States: Estonia, Latvia and/or Lithuania;
    b. Russia, Ukraine, Belarus, Moldova, Georgia, Armenia and/or Azerbaijan;
    c. Poland, Czech Republic, Slovakia, Hungary and/or Slovenia;
    d. Balkan States: Bulgaria, Croatia, Serbia and Montenegro, Macedonia, Bosnia-Herzegovina and/or Albania.

22. How many manufacturing sites does the company operate in Romania? _______

23. What year did the company start its operation in Romania? ________.

24. What year did the company start its operation at this site? ________.

25. Through what type of investment did the company begin operation at this site?
    a. Greenfield investment;
    b. Merger;
    c. Acquisition;
    d. Joint venture.

26. Is this operation
    a. wholly owned foreign affiliate;
    b. joint venture?
    If b), what percentage is Romanian-owned? ________________.

27. How many employees does the company have?
    a. At this site: ________________.
    b. In Romania: ________________.

28. How many employees did this company have at the end of its first year of operation at this site? ________________.
29. Please estimate how you expect employment levels to change at this site over the next 2 years:
   a. Increase > 20%
   b. Increase 5-20%
   c. Stable +/- 5%
   d. Decrease > 5-20%
   e. Decrease > 20%

30. What is the principal reason for this estimated change?___________________________________________________
    __________________________________________________________
    __________________________________________________________
    ______________.

31. Indicate or estimate how much has the company invested at this site ______________.

32. Please describe the main product made at this site?______________________________________________________
    __________________________________________________________
    __________________________________________________________
    __________.

33. Is the main product of this plant also produced at any other plants within the parent group? ______________.

34. If so, where? ______________

Questions about the respondent

Position in the company _________________________.

Nationality ________________________________

Thank you for taking the time to complete this survey. As part of my research I plan to conduct a series of interviews with foreign companies operating in Romania. These questions will cover the process by which foreign companies decide whether and where to locate in Romania as well as the nature of their relationship with local companies and local authorities. The interview will last approximately one hour. Anonymity of responses is guaranteed. Please indicate whether you would be interested in participating in a further interview.

Yes  I am interested in having an interview with you. You can contact me at:

   Phone: ____________________.

   Email: ____________________.

No   I am not interested in an interview with you.

Thank You!
Appendix C

Semi-Structured Interviews with Foreign Company Executives
Semi-Structured Interview with Owners or Managers of Foreign Companies in Romania

1. Talk about the firm (history, organization, etc.)
2. When did the company start to internationalize?
3. What were the conditions in the home country that allowed the company to internationalize?
4. When did you decide to expand to Eastern Europe (Romania)?
5. (If the company is not from Eastern Europe). Why did you decide to enter the Eastern European market?
6. In which other Eastern European countries is your company present?
7. Why did you select Romania? (If Romania is the only affiliate in Eastern Europe or one of the few), Why did you decide to come to Romania and not other countries? Please, tell me about the selection process.
8. Are you satisfied with what you found? Is it what you expected? What were the main problems your firm was confronted with?
9. Do you think the environment in Romania is pro-foreign investment? What could Romania do better to attract foreign investors?
10. How did you decide upon the location of your investment in Romania? Please, tell me more about the selection process? What were the main criteria that you used? How important was the cultural factor?
11. Do you use local suppliers? (If not), Why not?
12. During the past 3 years has there been any change in the geographical origins of the material inputs used by this plant? What reasons lie behind the changes described above/
13. What percentage of material inputs, by value is obtained from parent group? How has this percentage change in the past three years? What is the reason for this change?
14. Has the percentage of material inputs obtained from the ‘home country’ increased, decreased or remained roughly the same during the past 5 years? How would you explain this change?
15. Are you familiar with the concept of ‘just-in-time’ delivery? Is this plant operated based on this system? If not, are there specific reasons why this system is not applicable? Or specific barriers to its implementation?

16. How does this plant find out about possible suppliers of material inputs? Is there a purchasing department/team at the plant? Is there any input from the parent group? E.g. approved supplier lists, sharing information on suppliers, directed to use specific suppliers etc. Are suppliers changed frequently or does there tend to be a fair degree of continuity?

17. Who makes decisions about which material input suppliers are used by this plant? Managers at plant level or group-level involvement?

18. Going back to the main material inputs obtained from suppliers from this economic development region (or county), are there any specific reasons why “local” suppliers are preferred for these inputs? (Would the inputs be available from non-local suppliers?)

19. Would you characterize your (plant’s) relationship with this supplier as a ‘close’ relationship? Is it merely one of the buyer or supplier, characterized by arm’s length transactions or ‘off-the –shelf’ purchasing? Or is there a more co-operative approach? What sort of things does this co-operative/partnering approach entail? (frequent meetings and discussions; exchange of technical information, demand forecasts, open access to each others’ sites; joint production development). How long have you been involved with this particular supplier? What, would you say, are the benefits of this more cooperative approach to yourselves (better service/delivery, joint attack on input costs)? To your supplier (stable/guaranteed business; transfer of know-how; ideas; technology; learning best practices improves competitiveness)?

20. Local suppliers are in general large-size companies (over 200 employees)? Or predominantly small and medium-enterprises?

21. Do you expect the local input to increase or decrease over the next five years? What are the reasons for this expectation?

22. Do you sell your product locally?

23. Has there been any change in the geographical destination of this plant’s outputs during the last 3 years? How would you explain these changes?

24. Is the plant’s customer base dominated by large companies (200+ employees) or small and medium-sized companies?
25. Is there any limit on the geographical markets to which this plant may sell its outputs? Who sets this limit?

26. Do you contract services with local companies? What kind of services do you contract locally? What kind of services you cannot find locally?

27. Have you faced any specific problems since operating in this town (county)?

28. What is your relationship with local institutions (city hall, city council, county council, prefect, etc.)? Are they sensitive to your needs?

29. To what degree is your business dependent on local conditions? How easy would it be for you to move to another location?

30. Are you a member of the local Chamber of Commerce or another local business organization?

31. Is the company (or any of its senior managers) involved in local community projects, charities, etc.?

32. Is the company involved in local education (school links, sponsorship, work exp.)?

33. What resources does the plant have for R & D (e.g. specialist personnel and/or department, testing center).

34. Which of the following types of product research and development activities are undertaken at this plant:

   a. Pure research on new product technologies?
   b. Design/development of wholly new products? (just for this plant or on behalf of parent division or group? E.g. lead center status).
   c. Modification/upgrading of existing products;
   d. Adaptation/tailoring of products to suit specific customers/markets/
Appendix D

Semi-Structured Interviews with Local Authorities
Interview with Local Authorities

1. How would you appreciate the number of foreign investors and FDI flows to your county? Is it satisfactory?

2. In your opinion, what are the main factors that attract foreign investors to your county? (Or keep them at bay?) (and/or how would you explain the lack of interest from foreign investors in the past?)

3. How important do you think are local authorities’ attitudes in attracting foreign investors?

4. In your opinion, what is the role of foreign investors in local economic development?

5. Are foreign investors asking for your assistance? Most often, what do they request?

6. What can the county (city) offer foreign investors?

7. Has the county (city) ever turned down requests coming from foreign investors? If yes, why?

8. Is there anything you want foreign investors to do in exchange for your assistance (for instance, provide a certain number of jobs, sponsor local events, etc.)?

9. Tell me more about how the city (county) negotiates with foreign investors. Do they usually have a clear idea of where they want to invest when they come to you? How important do you think the city (county) is in influencing foreign investors’ location decision?

10. In your opinion, how do foreign companies impact on the local community?

11. How important, do you think, foreign investments are for local economic development?