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FOREIGN DIRECT INVESTMENTS AND INSTITUTIONAL PERFORMANCE: A ROMANIAN PERSPECTIVE

Our paper uses statistical tools with the aim of empirically investigating the institutional determinants of foreign direct investments (FDI) in Romania. The analysis is focused on the public policies that are relevant from the FDI perspective between 2002 and 2012; more specifically, we direct our approach towards identifying the manner in which state controlled instruments can be employed in order to increase the country's performance in terms of attracting FDI. The variables we use are the inflows of FDI to Romania, on one hand, and the set of Worldwide Governance Indicators of the World Bank on the other hand.

Keywords. Foreign direct investment, Romania, FDI determinants, institutional theory.

Introduction. Institutional theory deals with foreign direct investment (FDI) through the complex and uncertain environment in which they are located. From this perspective, the decision to locate foreign investments takes into account the institutional forces that shape the environment in which the foreign company will be implanted, such as regulations and incentives offered to foreign investors. The institutions are those that create the "rules of the game" in which multinational corporations and governments of the host countries are actors. In this context, FDI can be seen as a game or a competition between governments to attract foreign investment (Assuncao et al., 2011). Existing research highlights a number of drivers who take the logic of institutional theory to attract FDI, such as (i) the level of corruption; (ii) political instability and institutional quality as measured by assessing country risk, political freedom and civil coup number, the number of strikes, the effectiveness of law enforcement, etc .; (iii) financial and fiscal incentives: the level of taxation of companies, profit repatriation, concessions regarding taxes, tax rates effective bilateral and similar instruments.

Institutional theory is particularly important for countries in transition, which, in the process, acted specifically for the creation of institutions of a market economy. Empirical studies testing the impact of institutional variables on FDI in transition countries are numerous and they highlight the particular relevance of the institutional framework for investors. Bénassy-Quéré et al. (2007) emphasize the growing impact of the institutional aspect on the economic development of a country since the 1990s. A comprehensive analysis of the literature suggests a number of pillars underlying the framework of FDI attractiveness that are under the immediate influence of public decision-makers and public policy, as follows: (i) the level of corruption; (ii) the political instability and the quality of institutions: country risk, political and civil freedom, the number of hits, the number of strikes, the effectiveness of law enforcement; (ii) the financial and tax incentives: corporate taxation, profit repatriation, concessions regarding taxes, bilateral average effective tax rate (Altomonte (1998), Claessens et al. (2000), Garibaldi et al. (2001), Globerman and Shapiro (2002), Kinoshita and Campos (2003), Busse and Hefeker (2007)).

Our paper uses statistical tools with the aim of empirically investigating the institutional determinants of foreign direct investments (FDI) in Romania and of observing if any link between the two might be identified. The analysis is focused on the public policies that are relevant from the FDI perspective; more specifically, we direct our approach towards identifying the manner in which state controlled instruments were employed in order to increase the country's performance in terms of attracting FDI, at least from the perspective of perceptions on institutional performance. The variables we use are the inflows of FDI to Romania, on one hand, and the set of Worldwide Governance Indicators of the World Bank on the other hand. The period under analysis is 2002-2012, as these years are of particular importance for Romania, as for the other countries in Central and Eastern Europe: on the one hand, these are the years before and after the EU membership, the adoption of EU legislation and implementation of European practices, and on the other hand, they capture the effects of economic and financial crisis has left the attractiveness of Romania for FDI.

Our paper is organized as follows: in Section 1 we present an overview of FDI in Romania after 2003, in Section 2 we describe the data and research methodology, in Section 3 we outline the main results and in Section 4 we conclude and set down a few directions for future research.

1. Foreign direct investments in Romania – quantitative and qualitative issues. The potential positive contribution of foreign direct investments to economic growth is an issue accepted as such in the Romanian academic and political environment. At the same time, when one takes a look at the official statistics on FDI observes that the stock of FDI is at a rather low level (at least compared to the other Central and Eastern European economies) and the FDI inflows have considerably fall after 2007-2008, accompanied only by a shy increase in 2013 (in 2013, FDI inflow was EUR 2,712 million).

By economic activity (according to NACE Rev. 2), FDI was channelled primarily to manufacturing (31.1%), out of which the largest recipients were: oil processing, chemicals, rubber and plastic products (5.9%), transport means (5.7%), metallurgy (4.1%), food, beverages and tobacco (4.0 %) and cement, glassware, ceramics (2.7%). Apart from industry, other activities that attracted FDI were financial intermediation and insurance (14.2%), trade (11.2%), construction and real estate transactions (9.8%), and information technology and communications (6.9%) – see Figure 2.

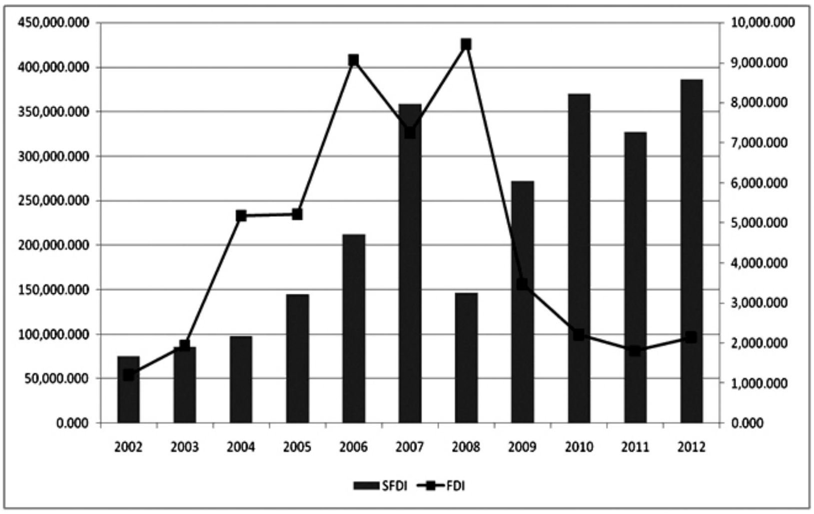

Fig. 1. Stock and flows of FDI in Romania, 2002-2012

Source: World Bank

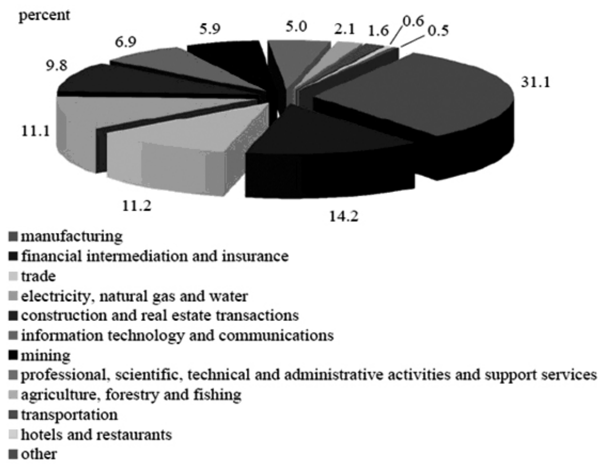

Fig. 2. FDI distribution across industries, end 2013

Source: National Bank of Romania

From a territorial point of view, FDI went mainly to BUCHAREST-ILFOV region (61.4 %). Other development regions benefiting from significant FDI inflows were: the CENTRE region (8.6 %), the SOUTH-MUNTENIA region (7.7%), the WEST region (7.6%), and the NORTH-WEST region (4.5%) – see Figure 3. In terms of the origin of FDI, the hierarchy is unchanged since 2009: the main investor is the Netherlands (24.4%), Austria (19.1%), Germany (11.2%) and France (7.6%).

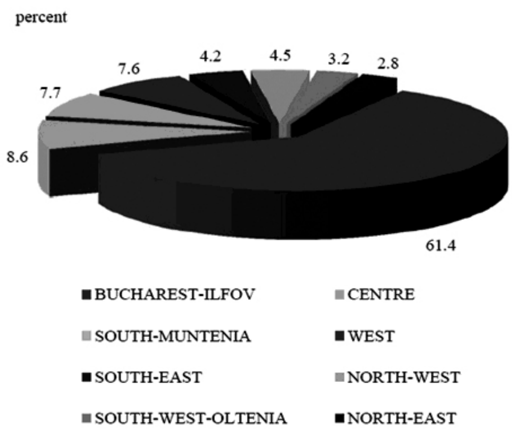

Fig. 3. FDI distribution across development regions, end 2013

Source: National Bank of Romania

Besides data and statistical measurements, the FDI volume reflects the attractiveness and quality of the Romanian business environment and the perception of foreign direct investors. It is interesting to mention that in 2012, a year that saw the Romanian economy grow by 0.7%, foreign direct investments inflows reached only EUR 1.6 billion, the minimum level of the entire decade. The causes of FDI evolution are internal and external; from an external point of view, the drop in FDI might be explained by the sovereign debt crisis in Europe (since EU investors dominate FDI inflows) and the increase in the level of risk aversion in the global economy (see Horobet, 2009, and Horobet et al., 2010); from an internal point of view, the management of the financial and European crises by the government, the mediocrity of Romanian infrastructure, the lack of institutional efficiency (bureaucracy, corruption, delays in public sector restructurings), might all be blamed for the low level of FDI inflows to Romania.

The institutional architecture, from the perspective of legislation directed to FDI and official bodies involved in attracting and supervising FDI, is another factor that explains the level of FDI. For what concerns the FDI legislation, Romania never benefited from the desired combination between a stable legal framework and high FDI offer. Between 1990 and 1996 the legal framework was attractive and stable, but the privatisation offer (FDI mainly came to Romania after 1990 by means of public companies privatisation) was extremely low and did not include public utilities or banks, which has not encouraged FDI inflows. On the other hand, the legal framework became unstable between 1997 and 2000, and discouraged FDI, despite a more generous privatisation offer. It is also noteworthy to mention that FDI promotional activity was split between various public bodies and institutions without an adequate budget, a situation completely different from the other transition economies. The Romanian Agency for Foreign Investments (ARIS – Agentia Romana pentru Investitii Straine) also functioned between 2002 and 2009; when created, ARIS replaced three governmental bodies holding responsibilities concerning FDI: the Direction of Relations with Foreign Investors, the departments in the Foreign Affairs Ministry and a Direction within the Ministry for Development and Prognosis. After ARIS dissolution in 2009, FDI promotion was assumed by the Ministry for Small and Medium Enterprises, Trade and Business Environment.

2. Data and research methodology. We use in our research data collected from the World Bank database on both foreign direct investments and institutional performance indicators. For FDI we use data on the flow of FDI (FDI) in million Euro, while for institutional performance we use data on the Worldwide Governance Indicators (WGI) calculated and published annually by the World Bank. The WGI are calculated on an aggregate basis and combine the views of a large number of enterprise, citizen and expert survey respondents in industrial and developing countries. There are six dimensions of governance considered in the WGI project, as follows: Control of Corruption (COR), Government Effectiveness (GOVEFF), Political Stability and the Absence of Violence (POLST), Regulatory Quality (QREG), Rule of Law (LAWAUT) and Voice and Accountability (VRESP). We briefly describe each indicator, based on World Bank methodology (see Kaufmann et al. 2010):

(1) Control of corruption captures perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests;

(2) Government effectiveness captures perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies;

(3) Political Stability and Absence of Violence/Terrorism measures perceptions of the likelihood of political instability and/or politically motivated violence, including terrorism;

(4) Regulatory quality captures perceptions of the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development;

(5) Rule of law captures perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence

(6) Voice and accountability captures perceptions of the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media;

These indicators are based on 32 individual data sources produced by a variety of survey institutes, think tanks, non-governmental organizations, international organizations, and private sector firms (Kaufmann et al, 2010). Fundamentally, these are composite governance perception indicators that use the individual data sources and rescale and combine them using a statistical methodology known as an unobserved components model. The six composite WGI measures are useful as a tool for broad cross-country comparisons and for evaluating broad trends over time. We use them in our analysis for the period 2002-2012 in order to gain insight into the relation between inflows of FDI in Romania and the quality of Romanian institutions and policies. The data frequency is annual. Figure 2 shows the evolution of these indicators between 2002 and 2012, while Table 1 summarizes the main trends (or their absence) in the evolution during the period under analysis.

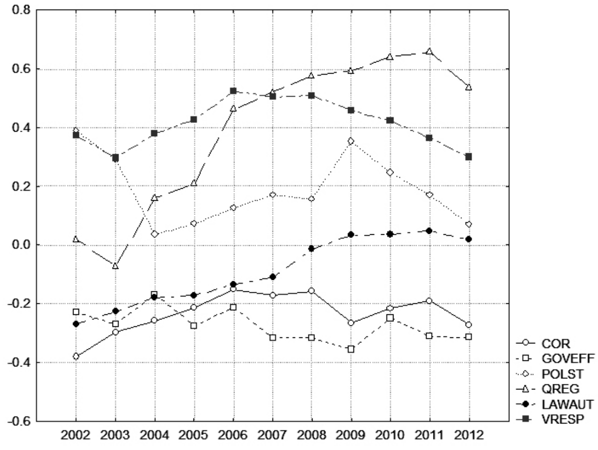

Fig. 4. WGI – Evolution 2002-2012

Source: Worldwide Governance Indicators and authors' computations

Table 1. **Summary of WGI indicators evolution 2002-2012**

Indicator	Evolutions
COR	Growth until 2006 and strong declining trend after 2007
GOVEFF	No clear trend, with positive and negative changes each year
POLST	The only period when political stability increased was 2004-2009 ; after 2009 the perception on political stability declined
QREG	Growing trend until 2011, and then decline in 2012
LAWAUT	The only indicator with a permanent growth between 2002 and 2012
VRESP	Growth until 2006 and strong declining trend after 2007

Source: Authors' computations

An interesting insight into the ability of these indicators to offer information on institutional quality in a country is given, in our view, by the correlations between them. In the case of Romania, the value of correlation coefficients and their statistical significance is presented in Table 2. We notice that three of these correlation coefficients are statistically significant at 5% level (the coefficient between QREG and COR – 0.650, the coefficient between VRESP and COR – 0.677, and the coefficient between LAWAUT and QREG – 0.922). These values suggest a positive and strong link between the perception on control of corruption and regulatory quality, on one hand, and voice and accountability, on the other hand, as well as between voice and accountability and regulatory quality. This means that a better perception on Romania's control of corruption (better corruption control in the country) is positively associated with better regulatory quality and better voice and accountability – still, from the correlation coefficient only one cannot detect which of the variables is the influence for the other. Also, this means that a higher confidence in the rules of the society is positively related to a higher regulatory quality. Overall, the WGI evolutions for Romania suggest that perceptions on institutional quality and performance have increased between 2002 and 2006, but have declined rather strongly after 2007.

Table 2. **Correlations between WGI indicators, 2002-2012**

	COR	GOVEFF	POLST	QREG	LAWAUT	VRESP
COR	1					
GOVEFF	-0.190	1				
POLST	-0.545	-0.229	1			
QREG	0.650*	-0.542	-0.17	1		
LAWAUT	0.450	-0.621	-0.104	0.922*	1	
VRESP	0.677*	-0.094	-0.064	0.451	0.143	1

Note: * – correlation is statistically significant at 5% level

Source: Authors' computations

3. Results. We plot in Figure 5 the values for each of the six WGI indicators against FDI between 2002 and 2012. The plots also offer information on the correlation coefficient between the two variables (bottom of the graph – r) and its statistical significance (bottom of the graph – p-value(p)).

The correlations between WGI indicators and FDI in Romania are as follows: three positive (FDI-COR, FDI-QREG and FDI-VRESP), one negative (FDI-PLOST) and two close to zero (FDI-LAWAUT and FDI-GOVEFF). Two of these correlations are strongly positive and statistically significant: 0.738 for FDI and COR, and 0.827 for FDI and VRESP. These results suggest that FDI inflows to Romania have been positively correlated with the perception on corruption control and on voice and accountability, but also negatively correlated with the political stability. It is noteworthy mentioning that both COR and VRESP declined after 2006, which might explain to some extent the plunge of foreign direct investments in Romania after the beginning of the crisis. At the same time, the link between political stability and FDI has been negative during the entire period – but political stability (as perception) increased only between 2004 and 2009; in the end, this result might be interpreted as the absence of an effective link between the two variables.

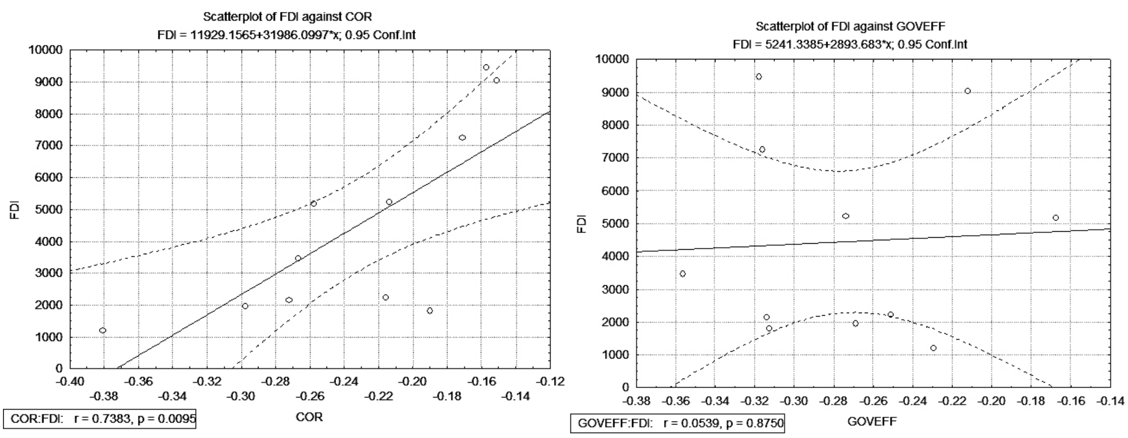

Fig. 5a. Scatterplots and statistical indicators for FDI against WGI indicators, 2002-2012

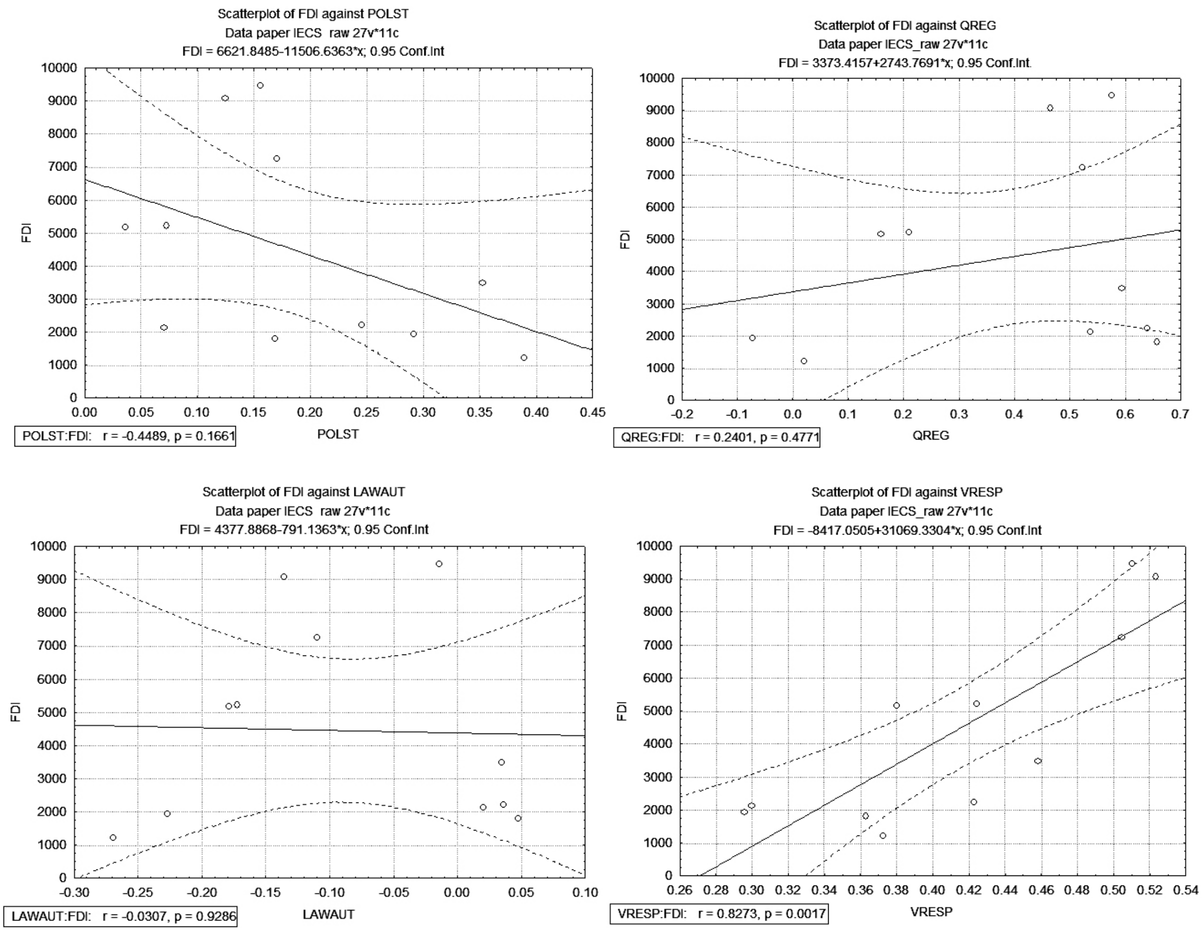

Fig. 5b. Scatterplots and statistical indicators for FDI against WGI indicators, 2002-2012

Source: Authors' computations

Conclusion & Discussion. Based on our research, it can be established a link between the quality of the institutional environment and FDI flows in Romania; in principle, the higher of the institutional framework quality the higher the volume of FDI. The experience of Romania after 1990 reveals two important aspects: first, the institutional framework for FDI was not a factor in attracting FDI (particularly those of significant size), but often a discouragement; second, FDI flows were correlated with two elements of the institutional framework: the control of corruption and voice and accountability. As a conclusion, we might say that foreign investors adjusted their presence in Romania to the negative evolution of institutional performance in Romania, especially after 2007.

It needs to be said, at the same time, that more research is needed in order to develop the statistical and econometrical analysis of the link between institutional performance and FDI. The following research directions might be pursued: (i) the use of a larger number of observations and, where possible (depending on the availability of data), a higher frequency (semi-annually, quarterly, etc.); (ii) the use of control variables, able to include a possible effect of intermediation between institutional performance and FDI (e.g., variables of economic performance, a gravitational variable etc.); (iii) The use of other variables indicating institutional performance (e.g, political risk indicators).

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ПРЯМІ ІНОЗЕМНІ ІНВЕСТИЦІЇ ТА ІНСТИТУЦІОНАЛЬНІСТЬ: РУМУНСЬКА ПЕРСПЕКТИВА

Наша стаття використовує статистичні інструменти з метою емпіричного дослідження інституціональних детермінант прямих іноземних інвестицій (ПІІ) в Румунії. Аналіз зосереджений на державних політиках, які використовували ПІІ між 2002 і 2012; більш конкретно, ми направляємо наш підхід до ідентифікації манери, в якій контрольовані державою інструменти можуть бути використані для того, щоб збільшити продуктивність країни з погляду залучення ПІІ. Змінні, які ми використовуємо: приплив прямих іноземних інвестицій в Румунії, з одного боку, і набір індикаторів Worldwide Governance Світового банку, з іншого боку.

Ключові слова: прямі іноземні інвестиції, Румунія, детермінанти ПІІ, інституціональна теорія.

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ПРЯМЫЕ ИНОСТРАННЫЕ ИНВЕСТИЦИИ И ИНСТИТУЦИОНАЛЬНАЯ ПРОИЗВОДИТЕЛЬНОСТЬ: РУМЫНСКАЯ ПЕРСПЕКТИВА

Наша статья использует статистические инструменты с целью эмпирического исследования институциональных детерминант прямых иностранных инвестиций (ПИИ) в Румынии. Анализ сосредоточен на государственных политиках, которые имеют отношение к ПИИ между 2002 и 2012. Более конкретно, мы направляем наш подход к идентификации манеры, в которой контролируемые государством инструменты могут быть использованы для того, чтобы увеличить производительность страны с точки зрения привлечения ПИИ. Переменные, которые мы используем: приток прямых иностранных инвестиций в Румынии, с одной стороны, и набор индикаторов Worldwide Governance Всемирного банка, с другой стороны.

Ключевые слова: прямые иностранные инвестиции, Румыния, детерминанты ПИИ, институциональная теория.

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INSTITUTIONALISM AND CRISIS

Contemporary scientific reunions and debates are focusing, for several years, on economic crisis. As a result, there are an unnumbered ways to analyse and to interpret the crisis. Our intention, in the present paper, is to analyze the economic crisis through another perspective: through the role played by institutions. Our scientific approach aims to examine whether public institutions play a role in the onset, progression or solve an economic crisis. For this we choose as representative public institution – the U.S. Federal Reserve System. To meet our purpose we focus only on Federal Reserve actions and their consequences, of any, by taking a short inside look to the Great Depression and 2007-2008 crisis. We tried to figure out which were FED's actions, were they suitable and effective? Could they be better, more appropriate to the specific situations? Those are questions that we try to answer in the present paper.

Keywords: institutionalism, crisis, monetary policy, Great Depression, 2007-2008 crisis.

Introduction. Between the concepts and meanings that transcend the past to the future the diversity of research areas, are *institutions* and *institutionalism*, corresponding to a constant interest shown by humanity. They are found among the most popular and yet blamed landmarks of ages.

As a general formula, *social institution* means an infrastructure subdivision that – through its importance and role – cannot only be investigated in so-called "formal patterns", but in a continuous interaction between form and content, taking into account the dynamics involved by such a socio-economic and legal conglomerate. As a result, the institutionalism has become a consistent approach of reality, where the essence of institutions role and powers can be marked by studying the structure and its functioning in an economic system. Judging in such a manner, one of the most evocative institutional images (the one of maximum scale) is the "institution's institution": the state. We, however, made a caveat: although the state would like to be omnipresent in society, it does not succeed, if only because it can be characterized as "the most powerful inertia machine" (it is true that sometimes, a necessary "brake").

Literature review. Institutionalism intended to explain certain principles of the market economy, which were not revealed or emphasized by neo-classics. Institutionalism related concepts have however contradictory character: on one hand, they demand to be backed by the element which owes their existence (the society), on the other, they take decisions and dictates, but not necessarily in the public or general interest. Here are some examples:

1) Thorstein Veblen's follower researchers adopted his theory (with minor changes), considering institutions as *given customs, invested with legal authority*. Their origin was searched, progressive, in moral conceptions or various psychological factors [1, p.363]. In this sense, the impact of economic events and intellectual movements became cause of the changes inside of social institutions.

2) John R. Commons insisted on adaptation trend of economic behavior to habits imposed by sovereignty of social and economic institutions. He conceived the evolution of society by reality driven changes (*pragmatic* sociology), showing that the modern economy can be known through the institutionalism. "This is the problem of modern economics, which is coming to be known as Institutional Economics. An institution is merely collective action in control, liberation, and expansion of individual action. It may be Communism, Fascism, or Capitalism." [2, p. 902].

3) Wesley C. Mitchell believes that between the evolution of economic doctrines, political events and institutions multiple mutual relations exist [1, p.365].

4) In William M. Dugger's conception, institutionalism basic task is to determine the understanding of the process of economic change over time [3, p.68].

5) Talcott Parsons sits to foundation of the institution as concept , so-called *value-type* (contract, property and