# INVESTMENT DEVELOPMENT PATH – THE CASE OF ROMANIA, POLONIA, HUNGARY AND BULGARIA

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***Abstract:***

*The level of development of a country can be measured with the help of investment development path. In this paper we aim to explore the case of Romania and see its evolution through the investment development path stages and make a comparison with former communist countries Poland, Hungary and Bulgaria, that became members of the European Union. To realize this comparison, we calculate the net outward investment for the selected countries and analyze their evolution. The investment development path is a tool used to evaluate the link between foreign direct investments and the gross domestic product of a country. We must acknowledge that this is only a side of the economic development of a country and the quality of the foreign direct investments is very important.*

***Keywords:*** *investment, European Union, communism, development.*

***JEL classification:*** *F21*

## Introduction

Foreign direct investments (FDI) represent an important part of the world economy as they are the tool not only for money transfers, form a country to another, but also managerial information and technology. Romania and the other countries from the communist block benefited from this source to accelerate the transition process to the free market economy and after that to accelerate country development. We must acknowledge that not all countries have the same characteristics and their development is influenced by them (Bellak, 2001; Bensebaa, 2008). Also, some FDI activities from the early years of the analysis were subject of corruption and "greasing the wheels" was a practice of those times. This had an important influence on the speed of country transition to capitalism, as corruption tends to slow development and potential investments from powerful multinational enterprises (MNEs) are driven away by the economic environment inside the country. Therefore, in the first years the level of inward FDI was low. After this period, which varies from country to country, the level of FDI begins to grow fast until 2008 when the international financial crisis affected all countries. After 2008 we see that the level of inward and outward FDI of Romania remains almost constant.

Our focus is to see how Romania and three other countries: Poland, Hungary and Bulgaria advances through the Investment Development Path (IDP) in the analyzed period and try to explain how they follow the theory and why there are some discrepancies.

## Description of the Problem

Lately the FDI flows began to change from the initial direction from developed to developed and developing countries, in a hybrid multi-direction between the two groups. Also, now, FDI is not realized only by the MNEs as new entities became involved in greenfield, or cross borders mergers and acquisitions like sovereign wealth funds, private equity firms, state owned companies or international financial organizations (Voica et al, 2018). Also there has been a surge of new MNEs

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from developing countries like China, India or Brazil that invest massively in US or EU (Dohse et al, 2012)

We have witnessed the change in paradigm of the developing countries from the beliefs that MNEs are the hand of imperialism that keeps them in underdevelopment (Narula and Pineli, 2016) and a risk to their economic and political sovereignty (Narula and Driffield, 2012) to engaging in a race to attract FDI by removing barriers and acknowledging the positive effects of FDI on the host country countries (Matei, 2004; Subic et al. 2010; Zaman et al. 2011; Zaman et al., 2012, Iacovoiu 2013; Zaman and Vasile, 2012, Anghelache et al., 2014; Popescu, 2014; Munteanu, 2015; Stancu and Iacovoiu, 2015; Anghelache et al. 2016; Iacovoiu and Stancu 2016; Podasca, 2017; Panait and Dusmanescu 2017; Panait and Voica, 2017).

In this new environment it is necessary to revisit theories like the IDP and see if they apply to the new conditions. The IDP theory has been first suggested by J. Dunning at the beginning of the 80's and after that Dunning and other researchers developed the theory (Dunning, 1986, 1997; Dunning and Narula, 1994, 1996, 2002; Narula and Dunning 2000; Lall, 1996; Durán and Úbeda 2001, 2005).

The IDP starts from the assumption that the flows of FDI are influenced by the level of development of the host country. If a country is underdeveloped, it has not the economic power to create outward FDI, even the level of inward FDI is very low as the potential investors seek different advantages to operate in a certain country in order to generate profit.

As the country develops it becomes more attractive to potential investors who will invest in it and by doing so contributing to further development of the country in an accelerated way. As the level of development becomes higher the country starts engaging in outward FDI.

The IDP is a framework that uses the net outward investment per capita (NOI/capita) position calculated as the difference between outward FDI and inward FDI and the gross domestic product per capita (GDP/capita) as a proxy for country development. The construction has five stages of development (Dunning and Narula, 1996; Buckley and Castro, 1998, Narula & Dunning, 2010, Narula & Guimon, 2010) and we can see an illustrative draw of the graphic in Figure 1.

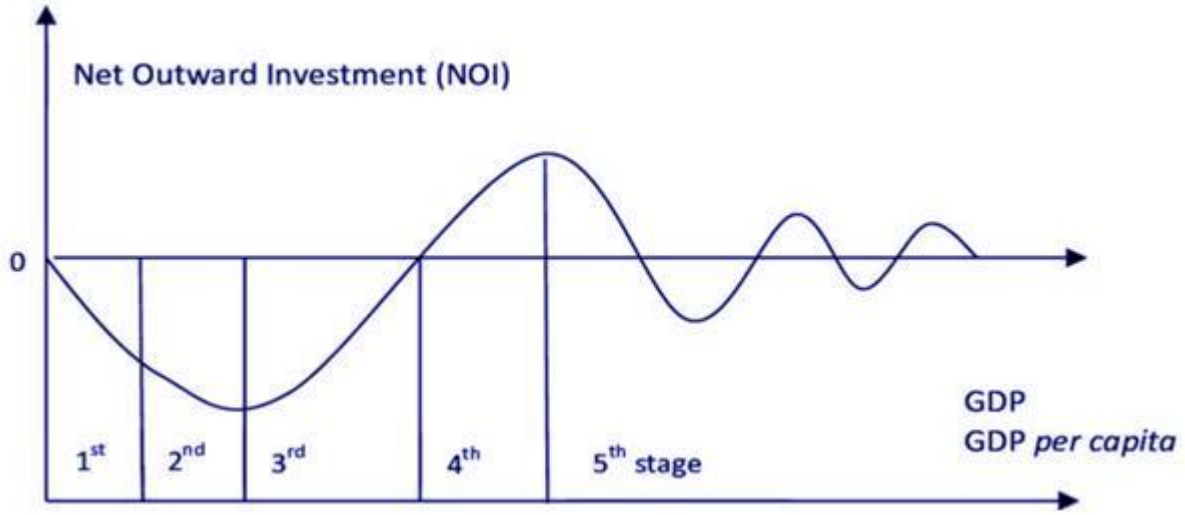


**Figure 1: The Investment development path evolution**

*Source:* adapted from Dunning & Narula (1996)

In the first stage we find the least developed countries or underdeveloped which don't have the advantages needed to attract potential investors. These countries have a low level of inward and outward FDI. Many times, outward FDI are inexistent and the inward investment mainly target natural resources.

Stage 2 countries have an ongoing development of specific location advantages like improvements in infrastructure and a bigger national market. In this stage the level of inward FDI is increasing and targets labor intensive industries and branches of manufacturing.

This is the stage where the inward FDI begins to have an important impact on GDP and has a higher rate of growth than it. Outward FDI keeps low as local companies don't have the strength to sustain activities outside their borders.

Stage 3 countries don't record the same increase in inward FDI, and they may be exceeded by outward FDI. Domestic companies become stronger in this stage and more competitive and will involve in resource seeking investments in developing countries and asset or market seeking in more developed countries. Countries from this stage have a good infrastructure and a working legal system.

In stage 4 the outward FDI is increasing faster than inward FDI and NOI is becoming positive for the first time. This was the last stage in the first form of IDP and is typical for the developed countries.

Stage 5 countries see a fluctuation of NOI indicator around zero with very high levels of inward and outward FDI. This is specific to the most developed countries.

## Methodology and Data

In our analysis of the IDP we used the following steps of GDP/capita: stage 1 – under 2,500$, stage 2 – 2,500 to 10,000 $, stage 3 – 10,000 to 25,000 $, stage 4 – 25,000 to 36,000 $ and stage 5 – over 36,000 $.

Our focus is in the evolution of FDI and IDP in Romania compared with three other countries from the former communist bloc. The three countries chose for the comparison are Bulgari, Hungary and Poland.

We chose Bulgari because is the country that has been accepted in the EU at the same time with Romania and it is its southern neighbor. We chose Hungary as it is its only other neighbor that is an EU member.

Poland was chosen as the champion of economic development of the former communist states and member of the EU.

The indicators used in the analyze are inward and outward FDI stock, GDP, GDP per capita and the population. All the data was extracted from United Nations Conference on Trade and Development (UNCTAD) for the period between 1990 and 2018.

We started from 1990 as then the communism countries became independent and started the path towards capitalism. The data was available until 2018 thus the finish year of our analysis.

We used the inward and outward FDI stock to calculate the net outward investment position (NOI) using the following formula:

$$NOI = OFDI - IFDI$$

Where: NOI – net outward investment
OFDI – outward foreign direct investment
IFDI – inward foreign direct investment
After calculating NOI we calculate NOI/capita, using the population, and along with the GDP/capita we will obtain the data necessary to draw the graphic representations which has as its x axis the GDP/capita and as its y axis the NOI/capita. According to Dunning and Narula (1996) the evolution of a country through the 5 stages of the IDP should look like in Figure1.

## Results

The GDP is one of the most used indicators to evaluate the economic development of a country. Therefore, we start our presentation with analysis of GDP which can be seen illustrated in Figure 2.

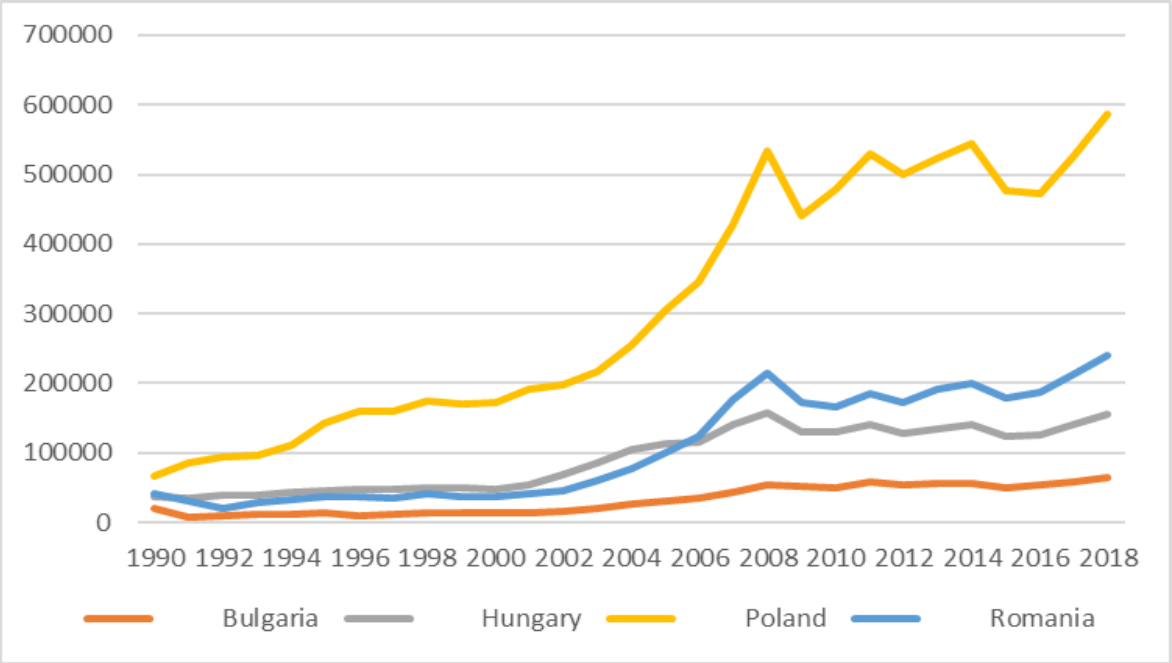


**Figure 2 – GDP for Bulgaria, Hungary, Poland and Romania, 1990-2018 (million USD)**

*Source: authors calculation based on data from UNCTAD*

In 1990 the total GDP of the four countries was around 164 billion USD, 40% was generated by Poland, 25% by Romania, 23% by Hungary and 13% by Bulgaria while in 2018 the total GDP of the four countries was around 1 trillion USD, 56% was generated by Poland, 23% by Romania, 15% by Hungary and 6% by Bulgaria. Therefore, we say Poland is the champion of former communist countries and surely out of the four selected in this study. Romania managed to keep almost intact its share in the selection losing only 2% while Hungary lost 8% and Bulgaria 7%.

In terms of population Poland is the only country that had positive evolution with a positive trend with an increase of 0.4%. The rest of the countries had a negative trend, Hungary with a decrease of 6.6%, Romania with a decrease of 16.6% and Bulgaria with a decrease of 20.4%.

The inward FDI had a similar evolution as the GDP and it is illustrated in Figure 3. The total inward FDI for the four countries was 463 billion USD in 2018 from which Poland accounted for 50%, Romania for 20%, Hungary for 19% and Bulgaria for 11%.

From the IDP point of view the level of inward FDI compared to the level of development is consistent with the theory as in the analyzed period all four countries pass from stage one to stage three.

Throughout the analyzed period the four countries had similar evolution with the difference that Poland and Hungary had higher growth rates than Romania and Bulgaria. Until 1998 Hungary was the leader by the level of inward FDI and from there on Poland took the lead until the present days. All countries saw an increased level of inward FDI between 2003 and 2007, but after the international financial crisis the trend has been disrupted for Romania, Hungary and Bulgaria, apart from Poland which had a growth of inward FDI higher than the other three countries.

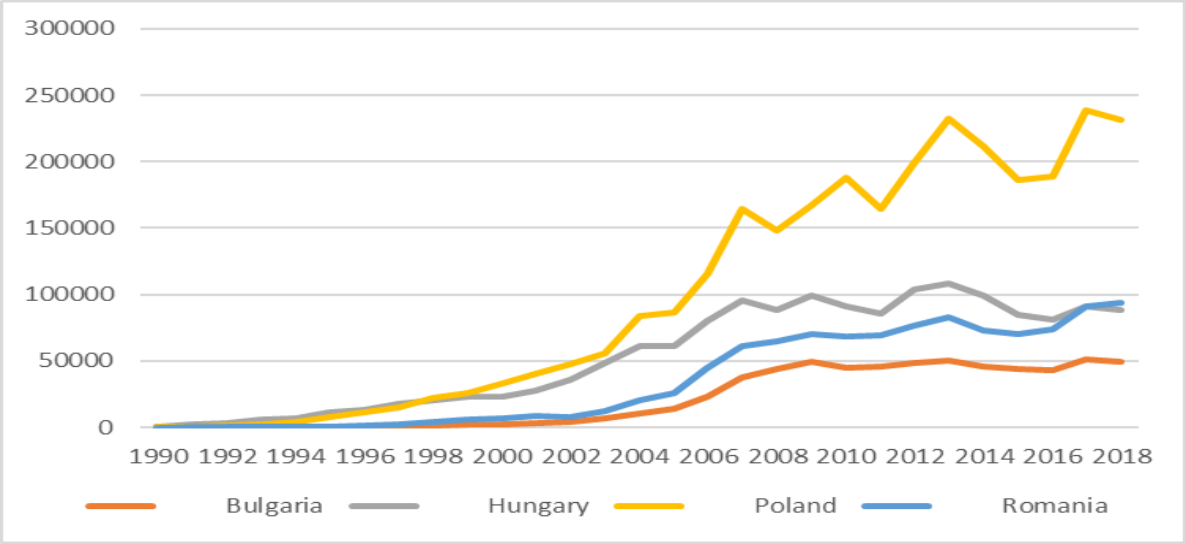


**Figure 3 – Inward FDI for Bulgaria, Hungary, Poland and Romania, 1990-2018 (million USD)**

*Source: authors calculation based on data from UNCTAD*

We must acknowledge that Hungary which is half in size compared to Romania attracted much more inward FDI. This can be explained by the fact that Hungary and Poland are closer to the developed countries of Central Europe and benefits of the gravitational effect of FDI.

The outward FDI, presented in Figure 4 is consistent with the IDP as in first stages the outward FDI is almost inexistent as we see until the year 2000. Then as the countries begin to pass to the next stages, we see an increase in outward FDI. Even though the difference between Poland and Hungary on one side and Romania and Bulgaria on the other side is very eloquent, the level of outward FDI for the first two is not enough to pass them in the developed countries of stage 4.

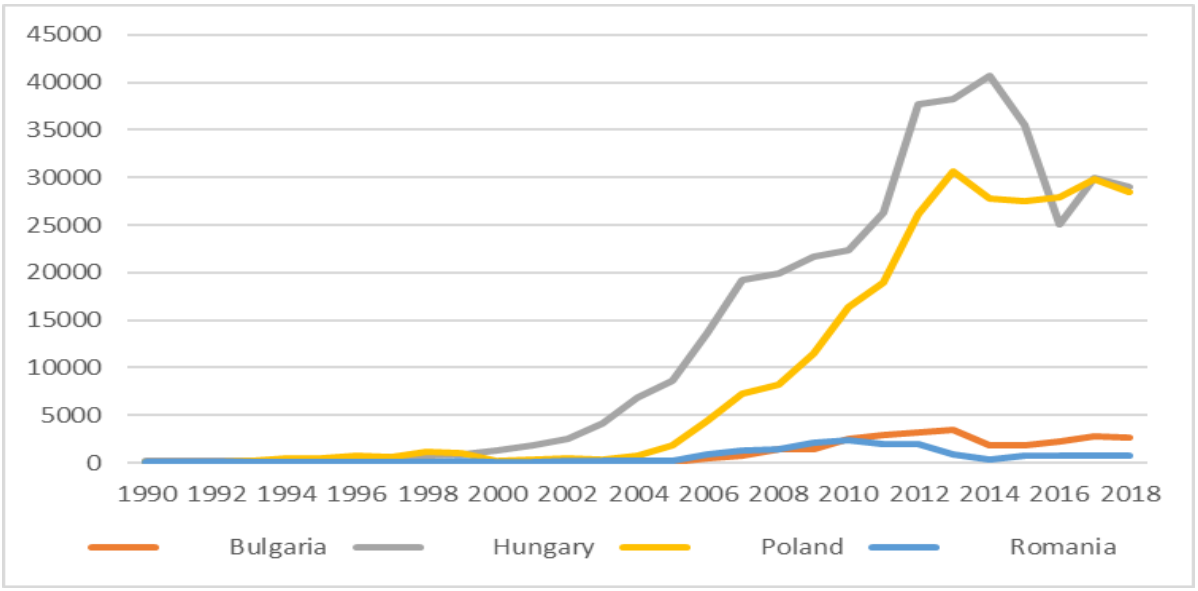


**Figure 4 – Outward FDI for Bulgaria, Hungary, Poland and Romania, 1990-2018 (million USD)**

*Source: authors calculation based on data from UNCTAD*

Based on the data collected from UNCTAD we calculated the NOI/capita and with GDP/capita we obtain the results presented in Figure 5. Each dot on the graphic represents a year of the analysed period. We used lines to connect the dots in order to bring up the chronological evolution. The GDP/capita analyse revealed that in 1990, Romania was in stage 1 of development alongside Poland and Bulgaria. The only country from the analysed group that was on stage 2 was Hungary.

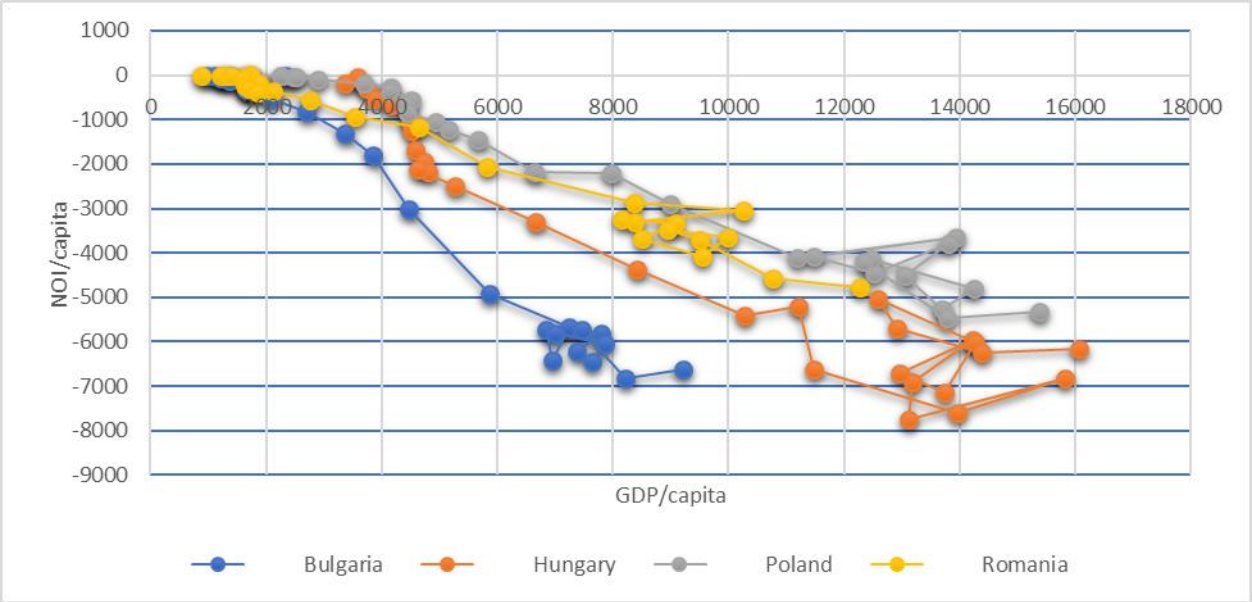


**Figure 5 – IDP for Bulgaria, Hungary, Poland and Romania, 1990-2018**

*Source: authors calculation based on data from UNCTAD*

By analysing the data, we observed that in the analysed period the GDP/capita of Romania grew 7.1-fold in 2018 above the level of 1990. All countries grew, but in different degrees, Poland is the in the top with 8.85-fold, followed by Romania, Hungary with 4.48-fold and Bulgaria with 3.93-fold.

Romania advanced to stage 2 in 2003 and for one year in stage 3 in 2008, but the international financial crisis forced it back to stage 2 until 2017 when it advanced to stage 3 again. Bulgaria advanced to stage 2 in the same year 2003 and remained there until the end of the analysis period. Poland advanced to stage 2 in 1993 and to stage 3 in 2007. Hungary advanced to stage 3 in 2004.

Throughout the analysed period all the countries registered negative NOI apart from the first two years for Romania and first year for Bulgaria. These values are explained by the inertia in which the former communism economies had operations abroad and the level of inward FDI was insignificant as potential investors kept away in expectation of better economic environment.

The data and the graphic illustration in Figure 5 provide us with enough proofs that Romania and the other three countries selected for this study follow the IDP theory until 2008 when the international financial crisis disrupted the trust between partners at international level thus affecting the flow of FDI. These problems along with other internal specific problems related to the Balance of Payments and international trade conducted to a disruption of the development measured by GDP/capita. This can be seen in the abnormal evolutions on the graphic from Figure 5 between 2008 and 2016. After this year the evolution seems to regain the trend existing before 2008.

## Conclusions

The IDP theory proved along time its usefulness and after the conducted analysis we observed that it is still applicable for our set of data. As stated in a previous work the theory is very good for stages 1 to 3, that is the case in our study, but we must acknowledge the difficulties posed for the stage 4 and 5.

Former communist countries from this study have the same evolution through the IDP as they were underdeveloped or starting their development. This is generated by the transition process from a centralized economy to a free market one. Even though there was a high level of industrial and agricultural development, the lack of managerial skills, legal framework and political will affected each country in different manners.

Becoming members of the European Union did not make domestic firms more willingly to invest abroad in the new market they got access to. Moreover, we saw an intensification of inward FDI as a result of this process.

The international financial crisis had a big impact on the flows of investments and level of development. After this catastrophic event the flows of FDI had to be reshaped and many years passed until the trend was regained.

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