HOST COUNTRY INVESTMENT ATTRACTIVENESS FLOWS OF FDI DRIVERS AND PSYCHIC DISTANCE: THE CASE OF ROMANIA

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ABSTRACT: *The political and economic situation at the beginning of 2022 brings with it an increase in concern about future developments and in uncertainty about the evolution of the world economy and the possibilities for recovery after the sanitary crisis. Global foreign direct investment flows registered a severe decrease of 35% in 2020 compared to 2019 according to World Investment Report 2021. The recovery will be uneven, and the perspective differs from region to region and to the level of economic development of each country. Consequently, competition between countries, in terms of investment attractiveness and increased absorption capacity of foreign investment flows, will be strengthened. This article aims to explore the possibilities of increasing investment attractiveness by reducing the psychic distance between the host country and the countries of potential foreign investors. Decision-making mechanisms on micro-level, by which managers of companies aiming to invest in other countries, also include perceptions of psychological distance, beyond aggregate macroeconomic indicators. Thus, increasing the investment attractiveness can be achieved by reducing this distance.*

KEY WORDS: *Foreign Direct Investments, Psychic Distance, Investment Attractiveness, Human capital, sustainable development.*

JEL CLASSIFICATIONS: *M20, M29, O11, O15, Q01.*

1. INTRODUCTION

The global economic context is becoming even more complex as the recovery of the negative economic effects of health crisis becomes an even greater challenge amid increasingly complicated developments: the war in Ukraine and its humanitarian and economic effects, the energy crisis and rising prices, disruptions in global supply chains. This volatile, uncertain, complex, and ambiguous environment raises serious

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issues that need to be answered by both business community and policy makers. One of these problems is the future of access to finance for companies, in the context in which investors are increasingly cautious. Foreign direct investments (F.D.I.) is an important source of financing for both developed and developing economies. Although their effect on economic growth remains a matter of debate, it is commonly accepted that they bring several benefits to the host country, such as job creation, increased competitiveness, technology transfer, know-how and managerial culture, business opportunities for local companies (Makiela & Ouattara, 2018).

Covid-19 health crisis affected global flows of F.D.I., that registered a severe decrease of approx. 35%, from 1.5 trillion US$ in 2019 to one trillion US$ in 2020, about 20% below the minimum level reached after the global financial crisis in 2008 – 2009 (according to World Investment Report 2021). The document highlights the sharp differences between the economies of developed and developing countries in terms of F.D.I. patterns, especially in terms of launching new projects and greenfield projects, developing economies being the most affected (a decrease in 14% for large infrastructure projects, compared to 8% in developed countries and a severe minus 42% in greenfield projects compare to only minus 19%). The recovery will be uneven and will depend not only on international developments, but also on the investment attractiveness and absorption capacity of F.D.I. of each country. So, investors are more cautions and in a process of reconsidering their strategies. Competition between countries to attract them increases. It should be considered a priority the identification and implementation of a medium- and long-term strategic options (not only short term) that increase investment attractiveness and resilience to other possible shocks. These options include the efforts made by countries that want to attract foreign direct investments to reduce psychic distance between them and the countries (business environments) where investors come from.

The assertion that the climate of competition between countries, in terms of attracting foreign investments sharpens amid tightening credit conditions and capital scarcity, remains relevant (Kobrin, 2005).

2. PROBLEM STATEMENT

F.D.I. flows and the benefits they bring to the host economies differ from a country to another. A paradigm shift has occurred starting with so called" Lucas`s paradox", the attempt to explain of global capital flows patterns by Robert Lucas. The model, summarized in The Theory of Endogenous Growth emphasizes the role of human capital in terms of investment attractiveness and spillover or propagation effect. Investing in training and skill improvement of human capital increase the host country absorption capacities of F.D.I. flows, attractiveness, productivity and competitivity (Lucas, 1990). Several significative contributors have added value to research on how multinational companies decide to invest in other than domestic markets and what are the variables they take into consideration in selection decision process. Other studies focus on the effects on host country economy.

The term of psychic distance appears for the first time in a paper that aims to explain the patterns of intra-European trade. Beyond the geographical distance measured in transportation cost, when it comes to purchases from foreign source, locate at similar distances, it is very likely that the choice will lean towards those sources that have been personally contacted and cultivated, that is located at closer psychic distance (Beckerman, 1956). Although Beckerman coined the concept, it was established in the business literature due to research undertaken by some members of so-called Uppsala School. There is a difference in approach in between. Uppsala School researchers considered psychic distance as a macro-construction when trying to explain the internalization models and comparing differences between countries, while Beckerman consider it a micro-construct related on manager`s perceptions. This fuelled frictions between various subsequent approaches (Ambos et al., 2019).

Followers of Uppsala School approach have built their arguments on differences in the flow of information from the market (as language, education level, business practices, culture) based on Hofstede's five cultural dimensions: the power of distance, the avoidance of uncertainty, individualism versus collectivism, masculinity versus femininity, orientation in time (Hofstede & Bond, 1984). Basing the research on transaction cost related to the information in the targeted market as a proxy for psychic distance it is emphasize the role of cultural and psychological variables as drivers of company's decision to choose one foreign market instead of another (Johanson & Vahlne, 1990).

Attempts of identifying factors that hinder or obstruct the possibilities of knowing a foreign environment are find (Vahlne & Nordström, 1993) and redefinition of the concept for a better understanding based on formation of perception differences about cultural and business practices (Evans & Mavondo, 2002). Investigations aimed at measuring the differences between countries and their effect at micro level, such as the decision to export or enter the market of another country, considering a more prominent role of psychic distance (Håkanson & Ambos, 2010) was conducted by several contributors, as well as on preference of firms to do business in markets with smaller psychic distance and adopt risk avoidance strategies by export or indirect sales before investing directly in countries with greater psychic distance (Blomkvist & Drogendijk, 2013).

Douglas Dow proposes a delimitation between the concepts of cultural distancing and psychic distance. His demonstration is based on testing a wide selection indicator, such as differences in language, religion, and political systems (so-called psychic distance stimuli), that Hofstede scales, used in isolation, have a weaker predictive validity. He emphasis the role of these stimuli in decision process of selection of foreign markets (Dow & Karunaratna, 2006).

The limitations of these contributions were grounds for reflections. James Nebus and Kah Hin Chai suggest that the research on psychic distance should integrate aspects such us: the foreign business environment, the manager's experiences, and the degree of familiarity with this environment, the manager's perception of these elements. They have replaced the conventional definition with the cognitive dimensions regarding the manager awareness of foreign context elements relevant to company decisions, perceptions about the extent of these relevant environmental elements and understanding the relationship between these context elements and company decisions (Nebus & Chai, 2014). Attempts to understand how the factors that drives trade and F.D.I. flows between different countries and world regions have materialized in different approaches perspectives on the processes of internalization and globalization as the gravitational model of psychic distance, considering business opportunities in other countries as an attraction force and the risk arising from this business, a rejection force (Bergamo & Pizzi, 2014).

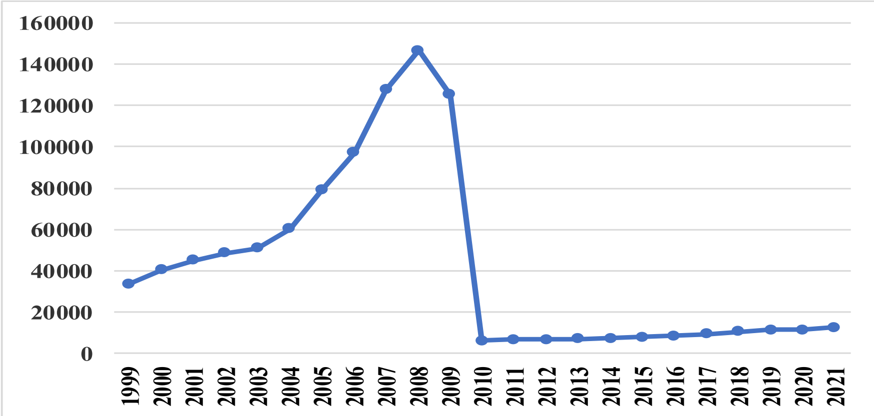
The C.A.G.E. (cultural, administrative, geographical, and economic) framework analyse how cross-border strategies add value to cross-border differences. Borders still matters and differences between countries are greater than are generally accepted. Rethinking global strategies considers how cross-border similarities become advantages and the identification of key differences is an analysis that reduces the vagueness of slogan" Think global, act local!" (Ghemawat, 2007).

Effects on host country's economies because of cross-border activities of foreign companies and the flows of F.D.I. is still a subject of debate. There are significant positive or malignant effects as contribution to economic growth and development, formation of fixed capital, job creation, positive impact on external payments balance (without increasing degree of indebtedness), strengthening bonds with local business environment being far less volatile as portfolio investments, implement of new technologies, know-how, managerial skills and entrepreneurial culture, access to new markets, improvement of efficiency and competitiveness of local economy (Moran, 1998). However, only some of host economies enter the" virtuous circle" of growth, namely those that manage to bear the impact of investments on human capital, that increase the impact of investments in real capital (Ranis et al., 2006). It means that positive effects are conditioned by certain characteristics of the host country. For example, new technologies will have a greater impact in countries that have a minimum threshold of human capital stock, highly educated labour force (Makiela & Ouattara, 2018). Several studies demonstrate that the probability of spillover effect is determined by the absorption capacity of host country that is the level of economic development and educational level. Spillover effect is a function of capacity to absorb F.D.I. flows of the host country (Kobrin, 2005).

Becomes an important issue for host countries to concentrate domestic efforts to capitalize the conclusion and extensions of endogenous growth theory by enriching human and social capital, innovation incentives, stimuli of entrepreneurial initiatives, to increase absorption capacities and real capital accumulation. The main objective is the raising life standard and general income. Improved domestic conditions allow host countries' economies to reap greater benefits from F.D.I. (Azam & Ahmed, 2015).

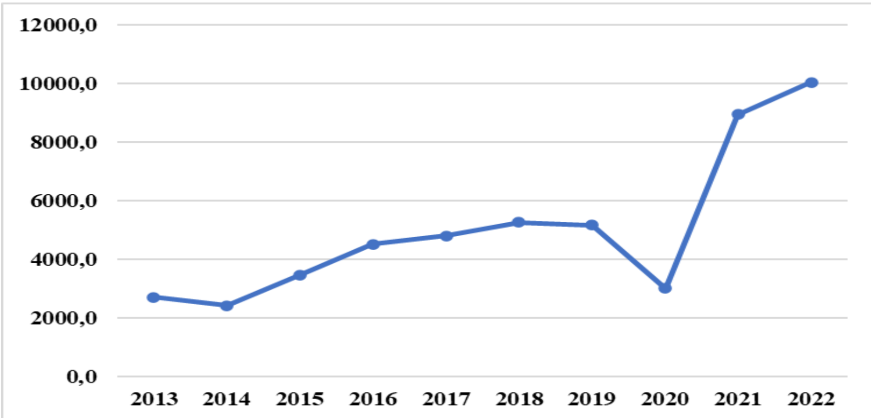
3. EVOLUTION OF THE MAIN ANALYSED INDICATORS

An analysis of the evolution of GDP per habitant between 1999 and 2021 was performed. From Figure 1, we can conclude that the GDP per habitant decreases from 33828,17 million euro in 1999 to 12718,78 million euro in 2021. The GDP per habitant decreases from this period with 706 million euro from year to year, with 3.23%. We also studied the evolution of FDI flows between 2013 and 2022. From Figure 2, we can observe that the FDI flows increases from 2712 million euro in 2013 to 10039 million euro in 2022. From year to year, the FDI flows increases with 814,11 million euro, with 15,65%.



Source: The National Institute of Statistics. The Annual Yearbook. Time Series 1990-2021

Figure 1. The evolution of GDP per habitant between 1999 and 2021.

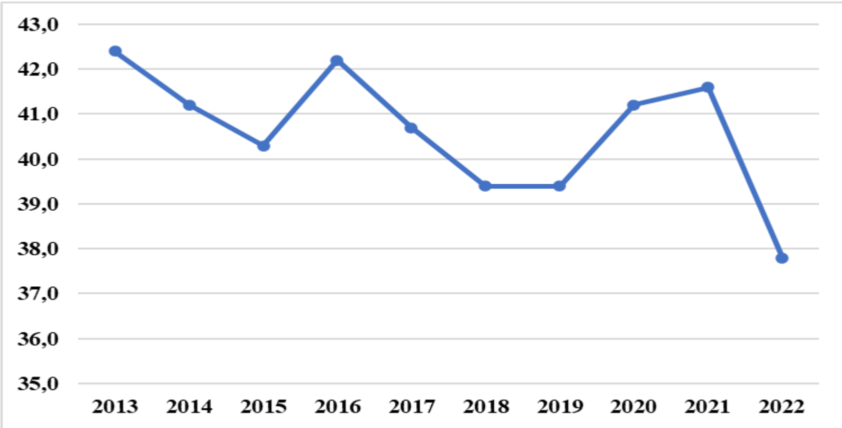


Source: National Bank of Romania, (2022), Foreign Direct Investment in Romania

Figure 2. The evolution of FDI flows between 2013 and 2022

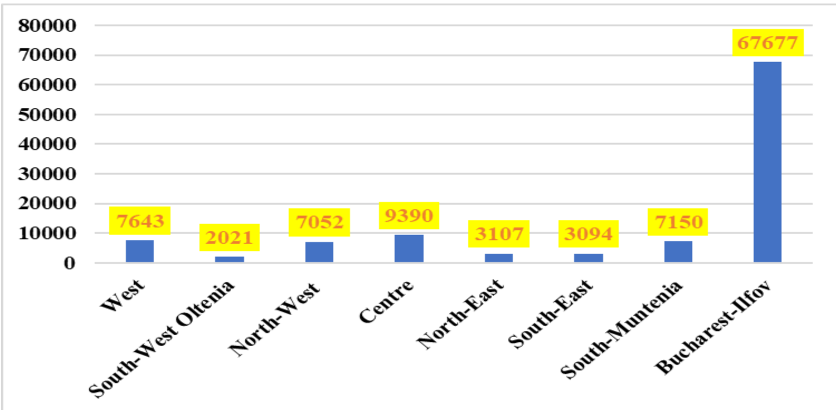
From Figure 3, we can observe that the FDI position/GDP decreases from 42.4% in 2013 to 37.8% in 2022. From year to year, the FDI position/GDP increases with 4.24%.

From Figure 4 we can conclude that the level of FDI in Bucharest-Ilfov was the highest level (67677 million euro), in West region the level of FDI was 7643 million euro, in South-West Oltenia region was 2021 million euro, in North-West region the level of FDI was 7052 million euro, in Centre the level of FDI was 9390 million euro, in North-East region the level of FDI was 3107 million euro (the lowest level), in South-East region the level of FDI was 3094 million euro, in South-Muntenia region the level of FDI was 7150 million euro.



Source: National Bank of Romania, (2022), Foreign Direct Investment in Romania

Figure 3. The evolution of FDI position/GDP between 2013 and 2022

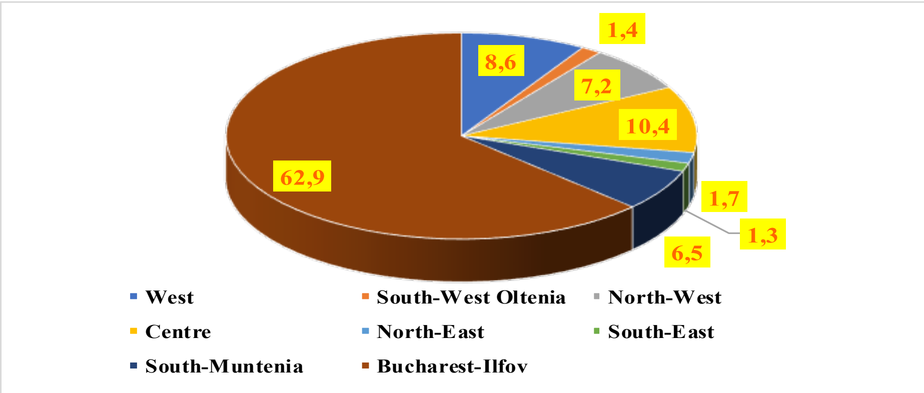


Source: National Bank of Romania, (2022), Foreign Direct Investment in Romania

Figure 4. The evolution of FDI position distribution by development region in 2022

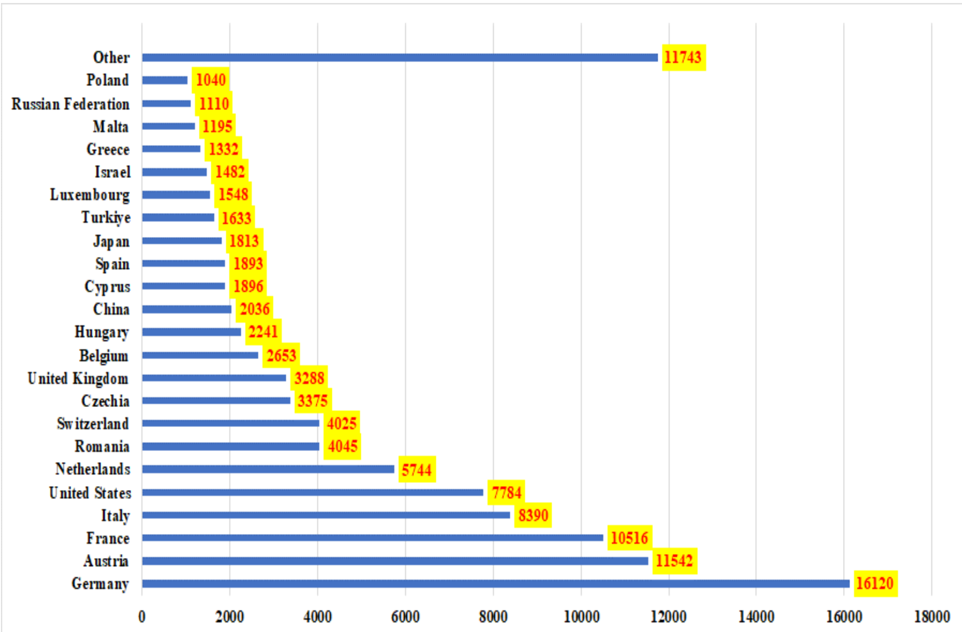
From figure 5 we can observe that the level of FDI in Bucharest-Ilfov was the highest level (62.9% from the total FDI), in West region the proportion of FDI in total FDI was 8.6%, in South-West Oltenia region was 1.4%, in North-West region was 7.2%, in Centre 10.4%, in North-East region was 1.7%, in South-East was 1.3%, in South-Muntenia region was 6.5%.

From Figure 6 we can conclude that the level of FDI in Romania of 4045 million euro, from Austria was 11542 million euro. Lowest FDI level is represented by Poland, 1040 million euro. In Hungary the level of FDI was 2241 million euro, a level about half from the level of FDI for Romania.



Source of data: National Bank of Romania, (2022), Foreign Direct Investment in Romania

Figure 5. The evolution of FDI position in greenfield enterprises by development region in 2022



Source of data: National Bank of Romania, (2022), Foreign Direct Investment in Romania

Figure 6. The evolution of FDI position by Ultimate Investing Country as of 31 Dec. 2022

3. CONCLUSIONS

The Netherlands (about 21.9%) was the main investor, regarding the time span between 2013 and 2022. While Germany (13%) and Austria (12%) are on the same place and for the fourth place is Italy from 2017 (7.6%).

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