

## THE EFFECTS OF CORRUPTION, POLITICAL STABILITY AND STATE INSTITUTIONS ON FOREIGN DIRECT INVESTMENTS IN ROMANIA

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### **Abstract**

*The article examines the consequences of corruption, political stability and state institutions on foreign direct investments in Romania as a result of the development of financial instruments and technological means. The paper examines the concepts found in the literature referring to the impact of corruptions on foreign direct investment and the power of the authorities to maintain the quality of their governance through the degree of economic liberalization. In this study, statistical data on corruption, foreign direct investments and governmental efficiency have been interpreted. The purpose of writing this article was to present the effects of corruption on foreign direct investments in Romania in order to generate new information on this topic that is not developed in the literature.*

**Keywords:** *effects of corruption, political stability, foreign direct investments, FDI.*

### **I. INTRODUCTION**

The changes brought to the global economy were major after the fall of the Iron Curtain and with the introduction of Eastern European countries into the world circuit. The new technological means eased the movement of capital across national borders and foreign investments can be considered as the engine of the globalization phenomenon. Although foreign capital can be drawn more easily than in the past, economic growth, the quality of state institutions, reforms needed to liberalize and create a prosperous business environment are motivating factors in attracting foreign investment in the emerging countries.

There are multiple studies in literature that demonstrate the impact of qualitative governance and the control of corruption on foreign investment. Oneal (1994) shows that cooperation between state governments and multinational companies can be beneficial to both sides, but he does not find any connection between governance and the level of foreign investment.

Li and Resnick (2003) develop Oneal's ideas and report that in exchange for bribery, multinational companies can obtain monopoly or oligopoly positions and other benefits to the detriment of local companies. Meon and Sekkat (2005) show that the level of corruption is determined by the quality of government institutions. The connection between corruption and the quality of governance is described through governance directories and the degree of liberalization of the economy.

Rodriguez (2005) presents a model where there are several types of corruption and the way these factors influence foreign direct investment in developing countries. The model contains two types of corruption: a universal form, encountered at large-scale and an arbitrary form encountered without a degree of certainty. Both forms of corruption have a negative impact on foreign direct investment due to the costs and uncertainties generated by this phenomenon. The study shows that most multinational companies are not interested in states where there is universal corruption, but where these companies are forced to overcome this phenomenon, arbitrary corruption is preferred.

In the case of Romania, there is only one study on corruption and foreign direct investment. Viorică, Jemna and Pintilescu (2015) use the corruption perception index to demonstrate the link between this phenomenon, the level of foreign direct investment and economic growth. The study shows that the phenomenon of corruption is positive and strongly correlated with the level of foreign direct investment, and foreign investment can be a factor in increasing corruption.

According to World Bank statistics, Romania ranks 62<sup>nd</sup> out of a total of 190 economies in the "starting a business" top, at the level of 2017. Reported to the regional average of 90.87, the "starting a business" index for Romania is of 89.48, placing our country on the second place, ahead of Slovakia, Hungary, the Czech Republic, Bulgaria and Poland. In recent years, the following steps have been taken to start a business:

- 2012: The process of registering a new company has been hampered by the introduction of the tax approval certificate for a new headquarter before the company registration;

- 2013: In this year, the time for obtaining the certificate was reduced by NAFA (National Agency of Tax Administration);
  - 2014: The process of starting a business was facilitated by transferring the responsibility for issuing the NAFA verification certificate to the Trade Register;
  - 2017: value added tax registration times have increased, making it difficult for a company to register;
- Globally, Romania's economy is on the 50<sup>th</sup> position, out of a total of 190 states, according to the "tax payment" index. At regional level, Romania ranks second in this ranking, surpassed only by Poland and Moldova. The reforms undertaken by the Romanian state regarding the payment of taxes consist of:
- 2011: a minimum profit tax was introduced, which was higher for companies;
  - 2012: the electronic payment system has been introduced and the minimum profit tax has been deducted;
  - 2014: the frequency of fees' payment has been reduced from quarterly to semester;
  - 2015: the electronic payment system was adopted by most companies due to the contributions brought to it;
  - 2016: Employer's social contributions and the contribution rate to the accident risk fund were reduced.

**II. ANALYSIS OF THE EFFECTS OF CORRUPTION, POLITICAL STABILITY AND STATE INSTITUTIONS ON FOREIGN DIRECT INVESTMENTS IN ROMANIA**

Although the effects of corruption are widely debated in the national mass media, the impact of the corruption phenomenon on foreign direct investment in Romania is not addressed in the literature. In order to make new contributions to this subject, a larger number of variables are added in the analysis, both in the category of corruption and in terms of political stability and state institutions:

- Corruption control, capturing the extent to which public power is exercised for private gain. This index includes the level of corruption and how the state is controlled by interest groups;
- Governmental efficiency, integrating the quality of public services, its degree of independence from political pressures, the quality and implementation of government policies, and the credibility of governmental engagement;
- Political stability, through the absence of politically motivated violence and terrorism, which measures political instability due to politically motivated violence;
- Regulatory quality that captures the government's ability to formulate and implement important policies and regulations that enable the development of the private sector;
- The power of the law, which aims at highlighting the extent to which the quality of contracts, property rights, police and courts, as well as criminal probabilities is respected;
- The voice and social responsibility that highlight citizens' perception of freedom of expression, freedom of association, freedom of the media and the extent to which they can contribute to the choice of government;
- Starting a business as a number of procedures and time in days;
- Registering a new property as a number of procedures and time in days;
- Payment of taxes, as a number of fees paid annually, the time in the annual hours for payment of taxes and the total tax on profit.

The analysis is made using SPSS v20, using the regression analysis method. The analysed period is 2006 - 2015 due to the availability of data. The data collection was done using the World Bank database and the enquiry of the publication "Doing Business in Romania". The dependent variable used in the regression analysis is the foreign investment stock at national level.

Annual data on variables are presented in Annex 1 and the results of the analysis are presented in Table 1.

**Table 1 - Correlation test results, ANOVA and regression coefficients of variables related to corruption, political stability and the quality of state institutions in Romania**

Variables	Pearson	F-test	t-test	Sig.
<b>The control of corruption</b>	<i>,216</i>	<i>0,393</i>	<i>10,309</i>	<i>0,618</i>
<b>Governmental efficiency</b>	<i>,693</i>	<i>7,387</i>	<i>2,718</i>	<i>0,026</i>
<b>Political stability</b>	<i>-,337</i>	<i>1,023</i>	<i>-1,011</i>	<i>0,342</i>
<b>Regulatory quality</b>	<i>,539</i>	<i>3,284</i>	<i>1,812</i>	<i>0,108</i>
<b>The power of the law</b>	<i>,694</i>	<i>7,434</i>	<i>2,727</i>	<i>0,026</i>
<b>The voice and social responsibility</b>	<i>-,441</i>	<i>1,937</i>	<i>1,392</i>	<i>0,201</i>
<b>Starting a business (number of procedures)</b>	<i>,602</i>	<i>4,542</i>	<i>2,131</i>	<i>0,066</i>
<b>Starting a business (days/year)</b>	<i>-,376</i>	<i>1,317</i>	<i>-1,148</i>	<i>0,284</i>
<b>Registering a new property (number of procedures)</b>	<i>-,814</i>	<i>15,74</i>	<i>6,82</i>	<i>0,001</i>

<b>Registering a new property (days/year)</b>	<i>-,661</i>	<i>6,203</i>	<i>-2,491</i>	<i>0,037</i>
<b>Total number of taxes</b>	<i>-,393</i>	<i>1,435</i>	<i>-1,198</i>	<i>0,265</i>
<b>Time needed for the payment of taxes (hours/year)</b>	<i>,395</i>	<i>1,475</i>	<i>0,743</i>	<i>0,479</i>
<b>Tax on profit (% total)</b>	<i>-,924</i>	<i>46,78</i>	<i>11,003</i>	<i>0,000</i>

### III. CONCLUSIONS AND DISCUSSIONS

The analysis shows that important variables in the foreign companies' decision to invest on the territory of Romania, government efficiency, the power of the law, the number of procedures, the time needed to register a property and the profit tax. The control of corruption, political stability, the voice and social responsibility, the number of procedures, the time needed to start a business and the total number of taxes did not seem to be relevant in the decision to invest in Romania. Although corruption is a broad phenomenon with major implications for economic development, the fact that the corruption control indicator was at similar levels in the analyzed period shows that the laws related to stopping the phenomenon and the institutions aimed at combating corruption achieve their objectives, and foreign investments are not influenced by the forms of corruption in Romania.

The governmental efficiency measured by the quality of public services, their independence from the political factor and the quality, the credibility and the implementation of the governmental policies achieve a positive and strongly correlated result from the statistical point of view. Through the efficiency of government programs, economic growth is recorded, which also leads to attracting foreign investors.

The compliance of contracts and the right of property, quantified by the "power of the law" indicator, shows the preference of foreign investors for a secure market where there are no risks and uncertainties about the future of these subsidiaries. The reforms adopted by the Romanian state during this period have strengthened the trust of multinational companies to invest in the national economy and future premises are positive, as long as these rights are complied with.

The timing and number of procedures required to register a property are other important factors in attracting foreign direct investments. There is a statistically significant negative and statistically strong correlation between the stock of the investments and these indicators, which demonstrates that the reduction of bureaucracy connected to the transfer of property impels multinational companies to come to Romania and, above all, to start greenfield<sup>1</sup> investments. From the point of view of the taxes, the total number and the time required for their payment are not an impediment, the only variable influencing the decision to invest in Romania being the total rate of the profit taxes. There is a negative correlation between the foreign investment stock and the profit tax, which is close to the absolute value 1. This correlation shows that with the increase in taxes the foreign investment number will decrease and the foreign companies will turn to other countries where they can register higher profits. In conclusion, the study brings new contributions to the subject and highlights the effects that corruption, political stability and state institutions have on foreign direct investment. The reforms undertaken by the Romanian state between 2006 and 2015 contributed to the national economic growth and, at the same time, to attracting multinational companies. The effectiveness of governance programs and respect for property rights and contractual rights are needed to strengthen a well built economy worthy of the attention of international companies. Reducing bureaucracy in construction and ownership is needed to further boost foreign investors, especially to start greenfield investments that bring more capital to the national economy. Keeping low taxes, especially below those of the countries of the region, is necessary to guide foreign investors to Romania and to provide them with an environment where they can obtain a higher profit than in other regional areas.

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<sup>1</sup> Greenfield is an investment where an investor starts a project from zero, on a land without infrastructure and in the end the firm it reaches a fully functional industrial unit.

**Annex 1**

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Control of Corruption: Estimate	53,17	52,91	53,88	49,76	52,38	52,61	48,82	53,08	53,85	57,21
Government Effectiveness: Estimate	36,10	29,61	29,61	27,75	32,54	28,91	30,81	42,18	41,83	40,38
Political Stability and Absence of Violence/Terrorism: Estimate	50,24	50,24	50,48	56,87	54,03	53,55	48,82	54,03	48,57	54,29
Regulatory Quality: Estimate	64,71	67,48	67,96	70,81	71,77	73,93	69,19	72,04	71,63	72,12
Rule of Law: Estimate	44,50	45,45	47,60	50,24	50,71	50,23	49,77	52,58	56,25	55,29
Voice and Accountability: Estimate	62,98	61,06	62,02	60,19	59,24	58,69	57,75	57,75	60,59	63,55
Starting a Business - Procedure (number)	6,00	6,00	6,00	6,00	6,00	6,00	7,00	7,00	6,00	6,00
Starting a Business - Time – Men (days)	11,00	11,00	8,00	8,00	8,00	8,00	12,00	8,00	8,00	8,00
Registering Property - Procedures (number)	7,00	7,00	7,00	7,00	7,00	7,00	7,00	7,00	7,00	7,00
Registering Property - Time (days)	77,00	77,00	77,00	77,00	19,00	19,00	19,00	19,00	19,00	19,00
Paying Taxes - Payments (number per year)	108,00	108,00	108,00	113,00	113,00	113,00	113,00	41,00	39,00	14,00
Paying Taxes - Time (hours per year)	192,00	195,00	204,00	204,00	204,00	230,00	224,00	218,00	202,00	161,00
Paying Taxes - Total tax rate (% of profit)	55,80	48,20	45,60	45,40	45,50	44,00	43,50	43,30	43,20	43,20