Russia's investment position in Romania

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The relationship between Russia and Romania is very interesting and by analyzing its economical, geopolitical, historical and cultural components one may understand why Russia has a strategic interest in Romania's key industries like the energy and steel sectors. This paper aims to find some of the particularities of Russian's investment position in Romania and analyze Romania's foreign policy in regards to the Russian Federation.

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JEL Classifications: F21 ; F23 ; O52.

Introduction

Without rising on a global level to the figures of Chinese foreign investments (directed mainly towards Africa and South America), nor having the impact of Japanese FDI or the coordination and focus of the U.S. or EU Member States (especially Germany, UK and France) FDIs, Russian investments are ubiquitous from Brazil to India, from

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the Balkan region to Switzerland, from Indonesia to Nigeria. And they do so in almost all economic sectors – from oil & gas and the energy industries, to tourism, hotels, infrastructure, luxury goods and gambling, to name just a few.

Strategic sectors like the energy production in Germany are indirectly controlled by Russian corporations and here the personal involvement and lobbying or the former Federal Chancellor Gerhard Schroeder in favor of Gazprom to build the Northstream and recently also the Southstream are not at all neglectable.

The Russians are present through Wingas, the natural gas trading company set up as a joint venture between Wintershall/ BASF and Gazprom, from Switzerland and Austria all the way to Croatia and Bulgaria.

Last but not least, football teams such as Scahlke 04 or Chelsea, national symbols of Germany or the U.K., are held entirely by Moscow tycoons.

Many of these acquisitions have been made based on investment advisory provided by some of the Big Four and have been financed by Israeli or UK banks, with which Russian companies have privileged business relationships.

Not less interesting is the observation that by entering the Romanian market, Russia assured its access to the entire EU market and by doing this it took direct or indirect advantage of management know-how, preferential fiscal treatments, access to unified quality standards ("made in the EU").

Most notable and impressive of all, Russia succeeded after 30 years of tough negotiations to accede to the World Trade Organisation ("WTO") , has become a member of the elite group of countries BRICS and stands good chances of being accepted and recognized by the OECD.

Analysis of foreign direct investment flows on a global level

Global turnover of TNCs and the added value created by these recovered considerably since 2010 and their overall sales increased by 9% in 2011 to a record level of $ 28 trillion. Thus, foreign affiliates of TNCs contributed in 2011 with more than 10% to global GDP and account for over 30% of global exports (UNCTAD, 2012). The internationalization trend of MNC is increasing, i.e. 41% define themselves as global companies in 2012 with operations functionally integrated, compared to only 33% in 2009. In addition, 70% of MNCs are more optimistic towards the investment environment in 2013 and see 8% more inter-company investment opportunities (UNCTAD, 2012bis)

Reflecting higher sales levels of TNCs, investment flows have recovered with 18% in 2011 compared to 2010 ($ 1,524.4 billion) and exceeded by 4% the nominal value achieved in the pre-crisis period. However, this value is still 23% below the level achieved in 2007. The increase was spread over all economic regions, although the types of investments that led to the growth differed regionally.

Although the FDI inflow to developed countries was dynamic in 2011, reaching $ 748 billion, an increase of 21% since 2010, the FDI inward stocks in these countries remained lower by 25% compared to the average recorded before the economic crisis (UNCTAD, 2012). After massive drop in FDI flows to developed countries during 2007 - 2009, both in nominal and relative terms, and historically lowest share in the global FDI in 2010, the increase in 2011 is due to FDI inflows in the EU, which have recovered by 32% compared to 2010 and reached $ 414.4 billion, while FDI flows to the United States decreased by 8%.

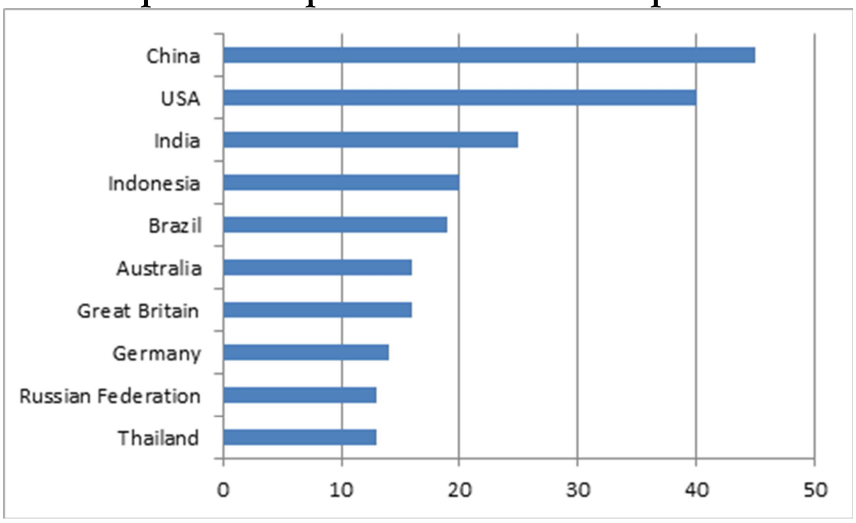
FDI flows to countries with developing economies and transition economies reached a record level of $ 777 billion in 2011, up with 14% and 31%, respectively, compared to 2010. The increase was mainly due to greenfield investments. It is important to note that developing countries and economies in transition have an increased importance in global FDI flows, both in terms of investment flows to these countries and of direct investments made by them abroad, which means that the MNCs continued to increase productivity in these regions.

For the first time since statistical data in gathered in this area, these groups of countries attracted more than half of global FDI flows in 2011, which means that developing and transition countries continue their FDI growth rate over the medium term.

Following the results of an investigation conducted in 2012 by World Investment Prospects Survey among TNCs, there were six developing and transition countries among the top 10 FDI receiving destinations for the period 2012-2014 (see Figure 1). It can be easily seen that almost all BRICS countries are more attractive than the U.S., Germany or Great Britain.

Figure 1

Top FDI recipient countries in the period 2012 – 2014



Source: "Foreign Investments - Forms of Market Entry" (Author's presentation using WIR 2012, cap. I and WIPS 2012-2014)

Similar to the FDI inflows, the FDI outflows began to recover in 2010 after drops of up to 39% per year from 2008 to 2009 and increased by 17% in 2011 compared to 2010 ($ 1,695 billion). However, these are still at a lower level compared to the period before the financial crisis and represent 77% of output flows recorded in 2007, maximum recorded so far.

There is an uneven allocation between regions and groups of countries, depending on their level of economic development (Popa/ Paraschiv, 2010). Developing countries and economies in transition show more dynamics, their share in total FDI outflows increased on average by 4% per year since 2007. However their ability to undertake financial commitments is lower than that of developed countries, therefore account for only 27% of total FDI outflows in 2011 ($ 457 billion). It is important to note that the gradual reduction of global FDI outflows starting with 2007 is mainly due to reduced foreign investments made by developed countries.

FDI outflows of $ 989 billion recorded in 2010 represent only 54% of their 2007 value, while foreign investment in the developing and transition countries in the period from 2007 to 2011 ranged to an average of around $ 400 billion per year (UNCTAD, 2012).

The comparative analysis of FDI inflows and outflows shows that MNCs located in developed countries revised their investment strategy and are now targeting investments in countries with developing economies, in an effort to maintain market share and achieve targeted profits. According to statistics published by UNCTADstat, only 51% of foreign investments made by developed countries in 2010 have been made in other developed countries (down from 68% in 2007).

In 2011, global investment flows rose in all three main economic sectors: primary (50%), manufacturing (10%) and services (20%) and the rise was widespread across all major economic activities (UNCTAD, 2012).

FDI growth in primary industry is mainly due to investments in the extractive industry (oil and gas) and electricity. Mining industry grew mainly in advanced economies and countries with economies in transition, due to increased demand. In manufacturing, the highest increase was observed in the food, beverages and tobacco and chemical industries (65% increase), mostly due to large investments in pharmaceuticals.

The energy market and Russia's strategic position

The selection of market entry mode depends on the level of involvement and the degree of diversification that the company has in mind when deciding to internationalize and on the degree competitive advantages reflect the ownership, location and internalization advantages. It also depends on the internal situation of each company or encountered market barriers. The selection of foreign markets is currently influenced by the economic and financial crisis, which invariable let to adapting the consumption patterns, now more oriented towards ecologically developed products and new opportunities of internationalization in areas such as green energy.

The energy market is particularly interesting to analyze, due to the strategic interes countries of the world have to ensure long-term stable access to resources.

The United Kingdom and the Netherlands, two of the three traditional North Sea natural gas producers, are expected to halt gas exports almost entirely before the end of 2019. Norway, the third largest natural gas exporter after Russia and Qatar, supplying almost 19% of Europe's annual consumption is also expecting a decline in gas reserves starting 2015 (Stratfor, 2013). Many European countries need to offset the medium term shortage of gas supplies without increasing again the imports of Russian natural gas resources, which means there is a strategic interest within Europe to diversify and integrate the energy markets, by trying to reduce Russian dependency. On the other

side however, Russia still has the political and economic target to dominate European energy markets and makes clear efforts to ensure the reliability of its future supplies to Europe.
Russia is among the top oil producers and exporters worldwide, reaching in 2012 10.4 million barrels per day, 65% higher than the average of the 1990s. More than half of its production is still exported to Europe, however with a decreasing trend over the past five years when European imports reached up to 80% of Russian gas production (see Table 1).

Table 1

Russian oil exports to Europe and Asia

Russian oil exports to Europe and Asia (in barrels per day)					
	Total Russian exports	Exports to Europe	Exports to Asia	*Europe % of total*	*Asia % of total*
2005	4,685,003	3,862,470	208,310	*82.4%*	*4.4%*
2012[1]	4,488,100	3,080,600	777,400	*68.6%*	*17.3%*

[1]December 2011- November 2012

Source: www.trademap.org based on data provided by Stratfor www.stratfor.com

With its oil and natural gas exports to Europe declining, Russia is virtually forced to expanding its energy export networks towards Asia in order to ensure steady revenues. This means however loosing or at least dramatically weakening Kremlin's leverage over European countries and attracts also additional risks in the Asian markets, which have traditionally rely their energy imports on Middle East or African countries.
From an economic perspective, Romania is an attractive market for Russian direct investments: the labor force is cheap and highly

qualified and there is a preferential fiscal system for attracting FDI. But there is also a geopolitical component explaining the significant investments mainly in the energy and steel sectors, given Romania's position and the historical relations with the Russian Federation.

Specifications of Russian FDI in Romania

Romania is still one of the favorite destinations among foreign investors in the CEE countries, attracting FDI inflow of EUR 1,815 million in 2011 and EUR 907 million in the period January to July 2012 (BNR Buletin lunar August 2012). According to the Romanian Center for Trade and Foreign Investment, the investments attracted created additional jobs in the energy sector and renewable energy equipment, services and various manufacturing activities, like textile industry and chemical processing industry (Romania Trade & Invest, 2012).

Russian investments in Romania are concentrated mainly in the above mentioned industries, whereas at the end of 2011 the gas & energy production accounted for 7.9% of FDI inward stocks, the oil & chemical processing industry for 6.3% and the mining industry and the steel industry account each for 5% of total foreign investments attracted in Romania (BNR/ INS 2012).

Although the drivers for internationalization are both of microeconomics and macroeconomics nature and vary from company to company, the main reason behind the decision is creating value for the shareholders.

Shortly after the fall of the iron curtain, major investments have been made in strategic and financially sound Romanian industries by Russian controlled or owned companies, like the aluminium production industry, steel and special steel, energy, civil constructions, gas distribution, mineral resources exploitation. Following, some of the most significant Russian investments in Romania and presented and analyzed.

The most recent Russian investment in Romania is the acquisition from OMV of 60 tank stations by the Serbian 100% Gazprom subsidiary, NIS. This transaction was initiated at the end of 2012 and the expansion prospects contemplate also regions outside the Carpathic area.

Lukoil is one of the largest vertically integrated oil and gas companies worldwide and the largest Russian oil company in terms of reserves, production and refining of crude oil, providing approximately 20% of domestic oil production and more than 2% of global oil production. Lukoil owns 1.1% of global crude oil reserves and has a yearly turnover of $ 81 billion and net income of over $ 10 billion. It is the 3rd largest non-state publicly traded oil company worldwide by proven reserves of hydrocarbons (6th largest by production of hydrocarbons).

In Romania, the company is present since 1998 and has approximately 20% current market share. Lukoil Romania has a network of 300 gas stations and 9 storage depots for petroleum products. Over the last 14 years, more than $ 400 million have been invested by Lukoil in Romania, creating 3,800 new jobs.

The Russian Steel Group Mechel is worldwide one of the largest producers of steel and steel products and the leading steel producer in Romania. Its business includes four segments: mining, steel, ferroalloys and power. The company is present in Romania since 2002 and owns currently 7 steel mills which employ over 7,000 blue and white collars, among which Mechel Târgovişte (acquired in 2002), Mechel Câmpia Turzii (acquired in 2003) and Ductil Steel Buzău (acquired in 2007).

In 2011, negotiations have been initiated between Mechel management and Romanian authorities in order to create and operate in joint venture energy groups.

The Russian billionaire Igor Ziuzin holds the majority stake in the mother company, Mechel OAO, and acts also as CEO. The company with a consolidated balance sheet amount of $ 19.3 billions and over

100,000 employees is listed at the New York Stock Exchange since 2004 and reported in the first 9 months of 2012 revenue of $ 8.8 billion and EBITDA of $ 1.2 billion.

Mechel is currently considering exiting five of the Romanian steel mills for an asking price of $ 150 million, which would return approximately 5 times the acquisition costs.

Vimetco NV, the Netherlands based Group formerly named Marco Group, is owned by the Russian billionaire Vitali Matsitski. It's a global player in the production of primary and processed aluminium, vertically integrated, whose main operations are in Romania and China. Vimetco NV is listed at the London Stock Exchange and controls production capacities of 680,000 tones per annum, managed by more than 10,000 employees.

Vimetco NV holds 87% of Alro Slatina, the largest aluminium producer in Central and Eastern Europe, with a production of 288,000 tones or primary aluminium in 2008. More than 80% of this production is traded on the London Metal Exchange or sold directly based on long-term agreements to international clients, from Austria, Turkey, the U.S. and other 20 countries.

For the first 9 months of 2012, Alro Slatina reported a net turnover of EUR 351 million and a net profit of EUR 18 million. Vimetco announced that it targets to become energy independent in Romania, for which begun at the end of 2011 the construction of an own thermal powerstation in Tulcea.

TMK is a company specialized in the production of rolled and welded steel pipes, the second largest producer at global level, with a turnover of approximately $ 3.3 billion. It is a public company listed on the stock exchanges in London and Moscow and controlled by the Russian investor Dmitri Pumpianski.

TMK owns seven metallurgical plants, out of which five in Russia and TMK-Artrom SA Slatina and TMK Reşiţa in Romania and exports its products worldwide through its own distribution network. The mother company recently announced its capital expenditure plans to invest anually $ 300 million until 2020, in order to maintain its activities and develop new products.

The acquisition of the termoelectrical plant CET Giurgiu by Global International 2000, indirectly controlled by Global Energy Investment, which is managed by Boris Golovin, is one of the latest Russian investments in Romania and the transaction finalized in 2010 for a net purchase price of RON 22 million.

In 2007, 51% of the Metalimportexport shares have been acquired by two Russian private investors for an estimated consideration of EUR 1.6 million. In the communist period, the company was focused on trading rolled steel and rolled or primary aluminium and reoriented after 1990 towards raw materials for the metallurgical industry.

Other notable Russian investments in Romania are those made by Mikhail Prokhorov in gold ore, by Petrochemical Holding owned by Iakov Goldovskiy in the Rafo refinery or by Luxoft through the acquisition of ICT Networks, active in the field of oursourcing IT services.

The Romanian investment environment for 2013 looks optimistic and there is a high interest from investors, expecially in the alternative energy sector (wind, biomass and biogas).

Conclusions

The analysis of some of the most significant Russian investments made in Romania clearly shows the strategic orientation towards key industries. We are seeing considerable acquisitions made in the most developed energy and steel companies.

Russia intends to continue strengthening its investments in these strategic sectors for the Romanian economy, primarily in the oil and energy fields, but also in the metallugical sector, by participating in the privatisation of state owned companies and by consolidating its current portfolio.

Although the political relationship between the two countries seem somehow frozen at the level of 2009, the economic relations are on a positive trend, for example trade increased by 35% in 2011 compared to 2010 (Lobjakas, 2012).
Romania represents a particular interest for Russia, based on economic considerations and foreign policy targets in respect of the European Union, especially after Romania reaffirmed during the EU – Russia Summit in Brussels (December 15th, 2011) its support for the EU's policies towards Russia and the accession of Russia to WTO (Lobjakas/ Mölder, 2012).
The Russian programme for efficient and systematic use of foreign policy in order to sustain the long-term development of the Russian Federation provides for strengthening the relations with the European Union and the United States, considered preferred partners. The main reason for this sudden change in Russian's foreign policy is the need to attract foreign investments in order to modernize the economy and the infrastructure.

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