

**SHORT-TERM MEASURES TO ATTRACT  
FOREIGN DIRECT INVESTMENT  
TO ROMANIA**

September 2003

**INTRODUCTION**

The Foreign Investors Council (FIC) is an association of leading foreign investors in Romania. The FIC has 85 members, whose combined investment in Romania exceeds EURO 5.9-billion, representing approximately two thirds of Romania's total foreign investment. The primary objective of the FIC is to foster dialogue between policy makers and investors in order to improve Romania's business environment and to assist in Romania's European Union (EU) accession process.

Although there has been an increase of foreign direct investment (FDI) of 20% in the first six months of 2003 as compared to 2002<sup>1</sup>, in 2002 the level of FDI per capita in Romania has lagged behind that of many other countries in Central and Eastern Europe<sup>2</sup>, despite Romania's political stability, availability of resources and access to export markets.

The FIC believe that, if implemented, its recommended improvements to the business environment will make Romania a more attractive place to invest and ultimately will result in increased FDI in Romania.

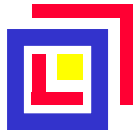
In turn, an increase in FDI in Romania will create a "virtuous circle" that includes the creation of new jobs; increased expenditures associated with the modernization of existing facilities; technology transfer; training of workforces to international standards; increased competitiveness in the global market place; increased exports; and finally increasingly successful businesses that can be taxed on their profits – taxes that in turn can be re-invested into infrastructure projects, education, health care, etc.

The FIC considers that its specific recommendations to improve Romania's business and investment environment will assist Romania to achieve successfully its objective of joining the EU in 2007.

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<sup>1</sup> Source: *National Bank of Romania*.

<sup>2</sup> The highest per capita inflow of FDI was registered in Czech Republic (\$468) followed by Croatia (\$297), Slovak Republic (\$270), Estonia (\$252), Macedonia (\$223), Hungary (\$207), Slovenia (\$171), Poland (\$168), Lithuania (\$126), Bulgaria (\$79), Latvia (\$72), Albania (\$66), **Romania (\$52)**, Bosnia and Herzegovina (\$30) and Yugoslavia (\$19) – Source: *EBRD Transition Report 2002*.



## POSITIVE DEVELOPMENTS IN THE INVESTMENT CLIMATE IN ROMANIA

The FIC are encouraged by a number of positive developments in the Romanian investment climate including:

- the continued improvement of Romania's macro-economic situation and especially the reduction of inflation;
- the strengthening of relationships with international financial institutions coupled with the consequent benefits to Romania's international credibility;
- the vote of confidence given by the international community to Romania through the invitation to join NATO;
- the introduction of clear, fair and easily applicable rules to calculate the value of minority shares, which allow minority shareholders to benefit quickly from the opportunity to realize their investments and which allow strategic investors to continue their investments thus reducing uncertainty in the business environment;
- the amendments by the State Privatization Authority (APAPS) to the law regarding the post-privatization regime and specifically the relaxation of the definition of "sources of investments" to include debt financing.
- the adoption of the ordinance on "silent approval" i.e. a strict limit of 30 days for the issuing of permits and a system of "silent approval": if no response is received by then, the investor shall consider the request approved. In addition, the ordinance ensures the necessary legal framework for the empowerment of "own responsibility" declarations instead of the required authorizations for certain activities;
- the transparency policy initiated by the Government of Romania (GOR) to post and regularly update on the Internet the list of significant debtors to the State budget.

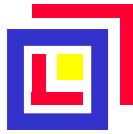
## AREAS FOR IMPROVEMENT TO THE INVESTMENT CLIMATE

The FIC has identified three specific areas for improvement namely: 1) labour market flexibility 2) level playing field and Rule of Law and 3) tax regime.

### 3.1 Labour Market Flexibility

The new Labor Code is a comprehensive piece of legislation that has a wide impact on virtually all Romanian companies. Unfortunately, certain clauses of the Labor Code are restrictive and not well suited for companies operating in a market economy.

Since its enforcement on March 1 2003, the Labor Code has produced adverse effects for both employers and employees. Employers are finding it difficult to implement and potential employees are finding less opportunities for employment due to the reluctance of employers to hire new people under such restrictive and bureaucratic conditions.



The main objective of the FIC's recommendations on the Labor Code is to improve the business climate for the benefit of all parties involved, including employees.

A Labor Code that lacks flexibility and prevents employers from hiring people will result in a "vicious circle" of less jobs leading to less tax paid by taxpayers, less money available for consumption, less savings to be invested in the economy and ultimately less growth for the country.

Out of the 300 articles of the Labor Code, the FIC believes that there are six critical issues that need to be addressed with priority by the GOR. In brief terms, the FIC's analysis and recommendations with regard to each of these six issues are as follows:

### **1.1 Wage Guarantee Fund**

The requirement to provide a "wage guarantee fund" to be used in case of bankruptcy of an employer is onerous and is not common in market economies.

*The FIC recommends that the wage guarantee fund be eliminated. However, we stress that the FIC is not against the principle of compensating employees who are victims of bankrupt companies, which the FIC believes should come from unemployment insurance.*

### **1.2 48-Hour Workweek**

The limitation of the workweek to 48 hours including overtime is not practical in many industries and should be relaxed to allow employees to work additional overtime if they so desire.

*The FIC recommends that, in line with the EU Directive 93/104/CE, employees be permitted to voluntarily work a maximum of 48 hours per week on average over a period of one year.*

### **1.3 Hiring and Dismissing Employees**

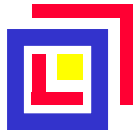
The documentation requirements associated with hiring new employees and dismissing existing employees that are incompetent or that fail to pass probationary periods are bureaucratic, cumbersome and time consuming. This bureaucracy will act as a disincentive for companies to hire new personnel.

*The FIC recommends that the procedure to dismiss incompetent or unsuitable employees be simplified and streamlined in conformance to EU best practice.*

### **1.4 Employee Conflict of Interest**

The requirement to pay a premium to employees who agree to a "non-competition clause" is not found in market economies. Furthermore, in competitive market economies, it is the norm to restrict employees from working concurrently with a competing company, which is an obvious conflict of interest.

*The FIC recommends that the requirement for an employer to pay additional wages for an employee's loyalty be eliminated.*



## 1.5 The Role of Trade Unions and Work Quotas

In market economies, employers and not trade unions are responsible for the production efficiency and overall management of their companies. Therefore, the requirement for employers in conjunction with their trade unions to establish “work quotas”, which legislate the work rate of both “blue collar” and “white collar” employees, is a step backwards.

*The FIC recommends that the requirement to establish work quotas be eliminated.*

## 1.6 Training

The requirement to provide training for all employees on an annual basis is excessive.

*The FIC recommends that employers train their employees on an “as needed” basis. Training should be carried out not because it is a legal requirement but rather to improve the skills of employees in order to develop a company. Therefore, the FIC recommends that each company with more than 100 employees issue an annual report on the training provided to their personnel. This report should be submitted to and followed up by appropriate administrative authorities.*

## 2 A Level Playing Field and the Rule of Law

In order to create a functioning market economy consistent with the EU *acquis communautaire* and a favorable economic environment for all competitors in the Romanian marketplace, there must be clear assurances that companies have the same fair chances of competing for opportunities and are subject to the same obligations towards the State. The FIC’s major recommendations to create a fair environment for all business competitors in Romania include:

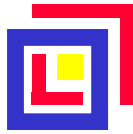
### 2.1 Level Playing Field

There are two areas that, if improved, may significantly level the playing field:

#### (a) Uniform Enforcement of Existing Legislation

A level playing field must be maintained for all investors, foreign and domestic. Universal application of existing laws, with special emphasis on strict and equal enforcement of tax collection, will contribute to higher government revenue. Many private and State-owned companies have been allowed to amass huge debts to the State on which penalties and interest are forgiven arbitrarily. The authorities’ participation in such practices amounts to subsidies for a few companies thus creating a distortion in the marketplace. In addition, this practice diverts needed resources from the State budget.

Tax collection will continue to be a problem if the GOR serves as a creditor to State-owned companies. In addition, it is an attractive alternative for some private companies not to pay taxes in a timely manner when penalties for late or non-payment are less than the interest charged by banks.



*The FIC recommends that:*

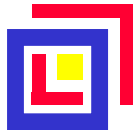
- *The enforcement of tax collection for both private and State-owned companies be systematically and uniformly applied.*
- *The GOR continue its transparency policy initiated in 2003 by posting and regularly updating on the Internet the list of significant debtors to the State budget.*
- *The GOR publish a comprehensive and aggressive plan to substantially reduce the budgetary arrears.*
- *Incentives be offered to accelerate payment of arrears such as a penalty moratorium (no penalties if arrears are paid within 12 months, 50% reduction if paid within 18 months, 25% reduction if paid within 24 months), PROVIDED THAT all current taxes are paid when due.*
- *Any company that has unpaid budgetary arrears in excess of 36 months be liquidated.*
- *EU-compatible State aid rules be applied transparently with regard to tax forgiveness, under the consistent supervision of Romania's Competition Council.*
- *State aid decisions be posted on the Internet and the listing should include the existing schemes, the State aid applications and the awards.*
- *Existing bankruptcy laws be effectively implemented which would result in many loss-making private and State-owned companies being closed.*

**(b) Prior Consultation on Draft Legislation**

Prior consultation on draft legislation is important in order to assure a process that will lead to comprehensive, clear and transparent laws, which may be implemented in a fair and equitable manner for all players. Legislation should be based on dialogue and consideration for all stakeholders' interests. Currently, interested parties, including the Competition Council, are consulted only occasionally on new laws and their comments are not taken into account systematically.

*The FIC recommends that:*

- *Government Ordinance 396/2002 and Law 52/2003 be consistently implemented and all draft legislation affecting the business environment is submitted for comment to interested parties.*
- *Proposed legislation be posted on the Internet and published in a new section of the Monitorul Oficial al Romaniei.*



- *The Competition Council be given the right to oppose legislation restricting competition and that legislation on competition takes precedence over legislation on businesses and under which State aid is provided.*
- *The Competition Council's independence from political pressures be increased.*

## 2.2 Rule of Law

The Rule of Law, which is a fundamental aspect of functioning market economies, implies the existence of an independent judiciary, effective and accessible means of legal recourse, a legal system guaranteeing equality before the law, an effective executive and judiciary enforcing the law and, perhaps most important for Romania, the uniform enforcement of existing laws.

In order to increase domestic and foreign direct investment, which are essential for economic growth, Romania must demonstrate to potential investors that the Rule of Law will protect their investments and their contractual relationships.

*The FIC recommends that:*

- *The independence of the prosecutors and the courts from political pressures be increased.*
- *The reform of the judicial system be continued to assure investors that the Rule of Law prevails in Romania.*
- *The judiciary takes increased responsibility to guarantee that the laws are enforced in a uniform, predictable manner.*

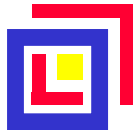
## 2.3 Fair and Impartial Judicial System

A fair and impartial judicial system is an essential component of the Rule of Law and is the ultimate guarantee that a level playing field can be achieved.

Romania's courts suffer from a shortage of trained judges and personnel. Therefore, court decisions in Romania associated with commercial litigation lack consistency and clear rulings based on sound legal argumentation. In addition, this shortage has contributed to a massive backlog of litigation and unacceptable delays in the administration of justice. Timely resolution of litigation and enforcement of court awards is an important factor in private-sector health and growth.

*The FIC recommends that:*

- *Judges be further educated to be able to solve increasingly complex commercial litigation.*
- *The caseload of judges be reduced to a level where they may devote the necessary time to fully understand the dispute and the appropriate application of the law.*



- *Judicial administration processes be streamlined through the use of IT; court clerks and other administrative personnel receive better training; terms between court hearings be shortened; subpoenas be served on time and efficiently; and the number of frivolous adjournments be limited.*

### 3.3 The Tax Regime

The Romanian tax regime shall be improved by the major step of introducing a new Fiscal Code, which is to be enacted after consultation with stakeholders in January 2004. There are a number of issues relating to the tax regime that are of concern to foreign investors in Romania. The FIC's major recommendations for improvement include:

#### 3.1 Establish a Code of Conduct for the Tax Authorities

The Romanian tax authorities appear not to have a Code of Conduct governing tax "controls" (audits). In many cases, these controls are carried out over a long period of time and may lack specific objectives. In addition, when carrying out controls, the tax authorities ignore the substance of a transaction and try to interpret the law to the disadvantage of the taxpayer. Furthermore, a long and protracted tax control means that the taxpayer has to devote considerable management resources to handling the control.

*Although the FIC recognizes that the GOR must protect its tax revenues and that taxpayers must be subject to tax controls in order to ensure that correct taxes are being paid, the FIC recommends that a "Code of Conduct" for the tax authorities should be embodied in the new Code of Fiscal Procedure. The Code of Conduct should clarify the rights and obligations of both taxpayers and tax inspectors. In addition, it should include an arbitration mechanism as an alternative to lengthy and costly court hearings.*

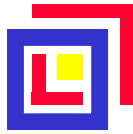
#### 3.2 Eliminate Delays in Value Added Tax (VAT) Refunds

Although legislation has been introduced that permits "fast track" VAT refunds (i.e., VAT refunds prior to control), unfortunately it has not been fully implemented. As a result, taxpayers continue to experience significant delays of up to a year or more in receiving VAT refunds. These delays create serious cash flow problems for exporters in particular, which find themselves in chronic VAT recoverable positions.

In addition, taxpayers who experience delays in receiving VAT refunds have difficulty in receiving payment of interest due to the delay.

*The FIC recommends that the GOR should immediately implement already existing VAT fast track refund legislation to permit qualified taxpayers to receive timely VAT refunds. Specifically, the Ministry of Finance should issue regulations governing the procedures for applying for fast track VAT refunds and confirm who within the tax administration is authorized to approve applications for these refunds.*

*In addition, the FIC recommends that interest should be paid on all delayed VAT refunds, in the same way as taxpayers are required to pay interest on all late VAT payments to the GOR.*



### 3.3 Implement a Tax Strategy for Romania

Romania does not have a published tax strategy, in contrast with a number of EU countries that have set out formally the aims and objectives of their tax regimes. For example, a tax strategy could include a statement about the rates that will apply for the next three to five years for corporate profits tax, VAT and personal income tax.

In addition, Romania has not made a clear statement as to when it will adopt fully the Organization for Economic Co-operation & Development (OECD) standards in relation to tax laws, nor has it indicated how and when EU convergence criteria will be adopted in relation to tax legislation.

If Romania's tax strategy is clarified, it will enhance its reputation as a stable and dependable country in which to invest. Similarly, clear undertakings from the GOR to align its laws in compliance with OECD and EU best practice will enhance its image as a country with a reliable and predictable tax system. The added stability that would result from these measures will contribute towards achieving increased FDI, EU accession and accelerated economic development.

*The FIC recommends that the GOR publish its tax strategy in relation to proposed tax rates for the next three to five years.*

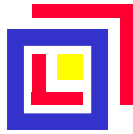
*In addition, the FIC recommends that the GOR make a clear statement as to when it will fully adopt OECD principles in relation to the interpretation and implementation of tax law, and when it will adopt EU convergence criteria in relation to tax law.*

## CONCLUSIONS

FIC members are in a position to facilitate effective implementation of the *acquis communautaire* by making available to the GOR their experience of similar processes in other countries.

Romania is steadily enhancing its international credibility. Actions already taken and proposals in the course of implementation indicate that the improvement of the investment climate is a high priority for the GOR.

The FIC believes that the measures proposed by our organizations will enable further improvements in Romania's business and investment environments and will thereby contribute to attracting FDI and to helping Romania successfully achieve its objective of joining the EU in 2007.



FOREIGN INVESTORS COUNCIL

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