ROMANIA'S TRADE IN SERVICES: REAPING THE BENEFITS OF GLOBALIZATION

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Abstract

Ample anecdotal evidence over the last couple of years points to Romania's growing attractiveness as location for offshoring decisions by Western companies, and the subsequent rise in offshoring-related services activities. This paper aims to explore if and to what extent these relatively new developments are backed up by official trade and FDI statistics. Drawing on recent literature on the topic of services offshoring, it analyzes Romania's trade and FDI flows in services over the 1995-2008 period in terms of dynamics, composition and performance. The findings of the empirical investigation suggest that the remarkable export growth in some individual services categories in the last years, as well as the positive changes under way in the patterns of services trade are largely driven by globalization, i.e. by enhanced offshoring activities hosted by the Romanian economy.

Keywords: trade in services, FDI, offshoring, Romania

JEL classification: FO2, F14, F21, L80

1. Introduction

The current phase of economic globalization, characterized by revolutionary advances in information and communication technologies (ICT), and accompanied by far-reaching liberalization of trade and FDI flows, has to a significant degree been driven by the internationalization of services.

Services include activities as diverse as transportation, travel, communications, financial intermediation, distribution, construction, accountancy, advertising, market research, education, and health care. These activities account for a substantial and rising share of GDP and employment in almost every economy. But their importance goes beyond the services sector itself, as they are essential inputs into the production of virtually all other goods and services. Because the price and quality of the services available in an economy have major impacts on all sectors, an efficient services sector is an essential precondition for enhancing overall economic performance.

In the process of internationalization, services that used to be regarded as non-tradables can be increasingly subjected to the international division of labor. ICT and larger access to world markets increase the tradability of services in a revolutionary manner and allow cross-border trade in services to expand, providing companies with incentives to slice up the value-chain geographically. Hence, services activities

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are now less constrained in their choice of location then they have been traditionally, meaning that many types of services that where previously only tradable through the movement of the provider can be now supplied from remote locations, via telecommunications networks. For many companies in all sectors this means that the production of various ICT-enabled services may be "outsourced" or "externalized", i.e. turned over to other specialized companies. And if it can be "outsourced", then it can generally also be "offshored", i.e. turned over to specialized companies located outside national borders (Kirkegaard, 2005). By fragmenting the production of ICT-enabled services internationally – in locations situated outside the firms' home countries – companies can gain economies of scale from consolidating and standardizing their service activities across the globe (UNCTAD, 2004).

The growing internationalization of services and the greater ease with which services markets can be today contested worldwide create opportunities for developing new sources of export growth. It also offers the prospect of a much broader range of services and technical know-how that can be imported efficiently. Practically, export and import opportunities are strongly intertwined: imports of high quality and/or cheaper services are often an essential prerequisite for a more efficient and competitive domestic production and hence for increased services exports.

For countries capable to exploit the new opportunities, the internationalization of services can make a positive contribution to sustainable development and international economic convergence. In contrast, countries that fail to secure the efficient supply of services run the risk of falling further behind. However, in order to benefit from globalization and its attendant "splintering" or "fragmentation" of the production chain, enterprises must have access to efficient services inputs. Hence, to harness the new opportunities associated with this process countries need to consolidate their capabilities to generate services flows, and improve the efficiency in the provision of services. In the increasingly competitive global setting, access to services in a cost-effective manner has become a key determinant of companies' competitiveness.

These remarks bring us to the following questions: What are the current trends and patterns shaping Romania's international services flows? Did the country benefit from globalization so far? Answering these questions is all so more timely and appropriate as the development of numerous services categories started from an extremely low base, and Romania ranked among the least services-oriented economies in Central and Eastern Europe (CEE) at the beginning of the transformation process.

On the other hand, in the context of the recent waves of EU enlargement, Romania has caught increasingly the attention of media reports worldwide for its high potentiality as target of offshoring decisions by Western companies. Subsequently, another question arises: What happened during the more recent years in the area of services flows so as to fuel the quite large amount of anecdotal evidence backing up Romania's growing attractiveness as offshoring location?

This paper attempts to find the answers to the above questions.

Section 2 gives an overall picture on the dynamics, composition and performance of Romania's trade in services over 1995-2008, and documents a set of features which might be relevant for enhanced services offshoring. Section 3 summarizes the main points arising from the literature on the topic of services offshoring, and sets out the conceptual and methodological framework underlying the analysis. Section 4 evaluates Romania's trade in offshorable services, and explores how well is the country suited to cope with the challenges raised by services globalization. Section 5 combines official FDI statistics with alternative sources of information to underpin the observed trends in services trade. Section 6 concludes.

2. Current Trends in Romania's Trade in Services: Soaring Exports and Emerging Structural Changes

The previous economic system left Romania with one of the most depressed services sectors and the longest paths towards a services-oriented market economy among the former communist countries in CEE. Hence, when looking into the evolution of the country's trade in services, it is of utmost importance to bear in mind the very low base it is growing from.

In the highly centralized Romanian economy, with nonexistent private sector and noncompetitive environment, with strong monopolistic positions of state-owned enterprises, lack of entrepreneurship and isolation from international markets, the scope for developing services in general, and business services in particular has been drastically restricted (Ghibuțiu, 1999). Besides, services have been relegated to a status of less importance in the process of growth and development both in terms of theory and economic policy. Implicitly, trade in services did not focus the attention of policy decisions. It was regarded as a mere complement to trade in goods (e.g. transports) or a source of foreign exchange earnings (e.g. tourism). And evidently only exports counted, while imports were oppressed.

Consequently, when Romania started to move towards market-oriented policies and institutions, a wide range of services categories, particularly business services (e.g. legal services, accounting and auditing, advertising, market research, management consulting, etc.) were either nonexistent or not developed according to Western standards. Nevertheless, since the start of the transformation process, Romania has experienced substantial progress in adjusting and opening its economy, and integrating it into the world economy both in terms of goods and services flows. The prospects of EU accession, the consequent adoption of the full body of EU law, as well as the gradual integration of Romania into the European market have further increased pressures to upgrade its services supply to the level of the old EU members, and to attract FDI into higher value-added services, including export-oriented services.

While progress in modernizing the domestic services industries and enhancing their contribution to the country's international trade flows has been remarkable, Romania is still lagging behind the EU-15 in many respects. Also, the discrepancies between Romania and several new EU member states (NMS) continue to be notable.

These may be in part explained by the specific starting conditions of the individual countries, but the primary cause relates to speed and depth in promoting economic and institutional reforms. Those NMS that managed to attract from the very beginning of the systemic transformation large amounts of FDI due to stepped-up and comprehensive economic reforms (e.g. Hungary, Poland, the Czech Republic) have witnessed a faster shift towards a services-oriented economy and, implicitly, a deeper trade integration in the area of services than Romania.

Table 1 illustrates the evolution of Romania's trade in services over the 1995-2008 period, and some of its salient features based on Balance of Payments (BoP) data.

Table 1: Romania's trade in goods and services, in 1995-2008

	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008
Trade in goods (EUR mn)										
Exports	6117	11269	12712	14676	15614	18935	22255	25850	29549	33614
Imports	7336	13099	16028	17437	19569	24258	30061	37609	47371	51813
Net	-1219	-1830	-3316	-2761	-3955	-5323	-7806	-11759	-17822	-18199
Trade in services (EUR mn)										
Exports	1155	1899	2270	2482	2671	2903	4104	5587	6931	8751
Imports	1407	2167	2398	2473	2609	3116	4448	5583	6454	7915
Net	-252	-268	-128	9	62	-213	-344	4	477	836
Share of services in total trade (goods and services) (%)										
Exports	15.9	14.4	15.2	14.5	14.6	13.3	15.6	17.8	19.0	20.7
Imports	16.1	14.2	13.0	12.4	11.8	11.4	12.9	12.9	12.0	13.3

Source: Own calculations based on bop statistics, national bank of Romania.

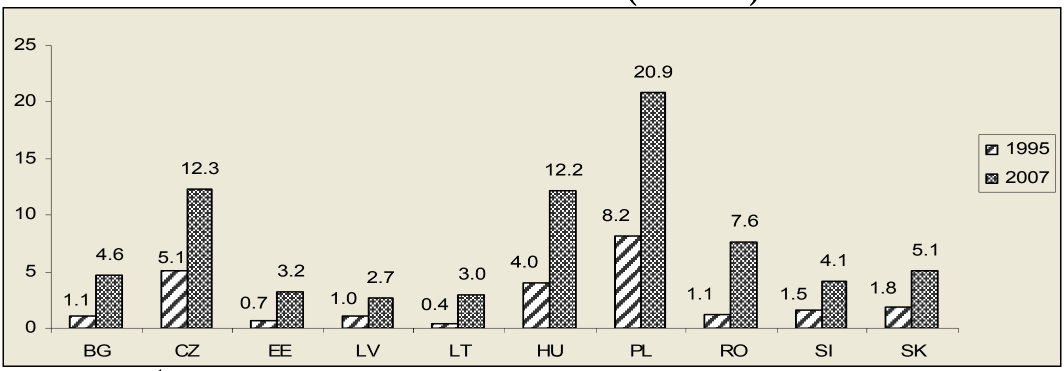
Trade in services has been expanding steadily throughout the analyzed period, with exports being presently over 7 times greater than in 1995, and imports almost 6 times. Services exports (in nominal terms) amounted to EUR 8.8 billion in 2008, while imports stood at EUR 7.9 billion. Notable is the rise in the share of services in total exports (goods plus services), i.e. from 16% in 1995 to 21% in 2008, which points to increasing involvement of domestic services industries in international trade flows.

The country's still modest weight in global services exports (0.3%) illustrates its relatively low export capabilities as compared to the old EU member states and even some of the NMS (e.g. Poland accounts for 0.9%, the Czech Republic or Latvia for 0.5%). This is in sharp contrast with Romania's size and potential. Nevertheless, a continuous increase of the country's participation in global services trade may be observed, with its share in world exports rising from 0.1% in 1995 to 0.3% in 2008.

Figure 1 illustrates the export volumes of Romania and selected NMS[1] in 2007 (latest year available) compared to 1995. With services exports growing more dynamically than in the EU and the world over the analyzed period, Romania managed to narrow he gap relative to the major NMS traders (Poland, the Czech Republic and Hungary), and ranked fourth in 2007 both on the export and import side.

As suggested by the ratio of total exports and imports to GDP, Romania (12%) is relatively less specialized in services trade than the EU-15 average (22%), but fares quite well when related to the global level (11%). Along with Poland (13%), Romania shows the lowest degree of specialization among the NMS, while Estonia (35%) and Bulgaria (28%) the highest (Ghibuțiu and Poladian, 2008).

Figure 1: Exports of services in Romania[1] and selected NMS[2], in 2007 *versus* 1995 (EUR bn)



Notes: [1] 2007 Eurostat data for Romania (RO) do not coincide with 2007 data in Table 1, the latter being revised; [2] See Footnote 1.

Source: Calculations based on Eurostat data (Ghibuțiu and Poladian, 2008).

However, quite interesting conclusions may be drawn when looking into the evolution of Romania's trade in services in the more recent years.

Firstly, services exports increased spectacularly over the 2004-2008 period, with their growth (CAGR) more than doubling compared to that of goods (32% and 15% respectively). Services imports grew also faster than imports of goods (26% and 21% respectively), but remained significantly below the growth of services exports (Table 2).

[1] Throughout the analysis, the selected NMS comprise the eight countries from CEE which became EU member states on May 1st 2004, i.e. Hungary (HU), the Czech Republic (CZ), Poland (PL), Slovakia (SK), Slovenia (SI), Latvia (LV), Lithuania (LT) and Estonia (EE), as well as Bulgaria (BG) that acceded on January 1st 2007 along with Romania (RO).

Table 2: Growth (CAGR) of Romania's exports and imports of goods and services, in 1995-2008 (%)

	1995-2008	1995-2000	2001-2008	2004-2008
Goods				
Exports	14.0	13.0	14.9	15.4
Imports	16.2	12.3	18.3	20.9
Services				
Exports	16.9	10.5	21.3	31.8
Imports	14.2	9.0	18.6	26.2
Offshorable services[1]				
Exports	33.7	40.2	30.8	47.6
Imports	17.6	18.1	19.2	25.9

Note: [1] See Section 3.2 for the specific services categories covered under this heading.

Source: Own calculations based on BoP Statistics, National Bank of Romania.

Secondly, the rapid expansion of services exports has been mainly driven by the "other services" component of services trade. Business services subsumed under this BoP heading recorded the highest growth over 2004-2008 (39%), and their share in total services exports increased from 43% in 2004 (29% in 1995) to 54% in 2008 (Table 3). This is a remarkable qualitative shift in the composition of Romania's trade in services and points to a highly dynamic process of structural adjustment. In the 1990s, the structure of services flows still reflected the inheritance of the past economic regime. It was characterized by the predominance of traditional services – such as transport and related services, as well as travel – and the quite low share of advanced business services.

Table 3: Structure and dynamics of Romania's trade in services, by main components, in 2004-2008 (%)

	Share of the main components in total services trade (%)					**CAGR** (%)
	2004	**2005**	**2006**	**2007**	**2008**	**2004-2008**
Credit, of which:	100.0	100.0	100.0	100.0	100.0	
Transport	43.1	29.0	26.8	**27.3**	30.8	21.1
Travel	14.0	20.8	18.5	**16.9**	15.5	35.2
Other services	42.9	50.2	54.7	**55.8**	53.7	39.4
Debit, of which:	100.0	100.0	100.0	100.0	100.0	
Transport	38.7	35.6	34.3	**37.1**	33.3	21.6
Travel	13.9	16.9	18.5	**17.3**	18.6	35.7
Other services	47.4	47.6	47.1	**45.5**	48.1	26.7

Source: Own calculations based on BoP Statistics, National Bank of Romania.

Thirdly, the outstanding growth performance of services exports over 2004-2008, combined with the relatively slower expansion of imports triggered an important positive shift in Romania's services balance, which seems to be sustainable for the first time since 1990 (Table 4).

Table 4: Romania's services balance, by main components, in 2004-2008 (EUR million)

Years		Total services, of which:	Transport	Travel	Other services
	Credit	2,903	1,252	406	1,245
2004	Debit	3,116	1,206	434	1,476
	Net	-213	46	-28	-231
	Credit	4,104	1,189	852	2,062
2005	Debit	4,448	1,583	750	2,116
	Net	-344	-394	102	-54
	Credit	5,587	1,498	1,034	3,055
2006	Debit	5,583	1,916	1,035	2,632
	Net	4	-418	-1	423
	Credit	6,931	1,892	1,171	3,868
2007	Debit	6,454	2,397	1,119	2,938
	Net	477	-505	52	930
	Credit	8,751	2,694	1,358	4,699
2008	Debit	7,915	2,637	1,473	3,805
	Net	836	57	-115	894

Source: Own calculations based on BoP Statistics, National Bank of Romania.

Unlike all the other NMS, Romania recorded chronic deficits in services trade since 1990, which have largely contributed to the structural deterioration of its balance of payments along with the huge and continually rising deficits in goods trade. However, 2006 appears to be a turning point as the modest net exports worth EUR 4 million have been followed by more substantial trade surpluses, i.e. EUR 477 million in 2007 and EUR 836 million in 2008.

Finally, another notable change can be observed when looking at the specific contribution of the three components to Romania's services balance. While "other services" have fuelled substantially and constantly the structural deficits in total services trade during the last decade, the net exports worth EUR 423 million in 2006 represented a very premiere. This trend reversal appears to be durable, as the respective net exports more than doubled in 2007 and 2008 (Table 4).

Hence, we may conclude that Romania's trade in services has clearly accelerated in the more recent years. Moreover, the remarkable expansion of services trade has been accompanied by favourable developments in terms of composition and performance, which have to be put on account of the highly dynamic "other services" component of trade. Further, it may be assumed that the outstanding export performances in business services included in this component are largely related to enhanced offshoring activities within the Romanian economy. The arguments underpinning this assumption are arising from the more detailed analysis of the "other services" component of services trade, which is supposed to cover those services categories which are prone to be offshored.

However, before moving to the investigation of Romania's trade flows through the lens of services offshoring it is important to provide a brief overview of the main conclusions emerging from the literature on this phenomenon, and also to clarify some related conceptual and methodological aspects.

3. What Is Services Offshoring?

3.1. Services offshoring: a new form of globalization

In the last couple of years, services offshoring ranked among the most hotly debated topics in the context of international economics. The highly dynamic developments revolving around this phenomenon widely focused the interest of both economists and politicians, and the public at large.

Despite ranking high on the media and policy agendas worldwide, knowledge about the complex issues involved in the phenomenon of services offshoring is still scarce. Research on this topic continues to be greatly hampered not only by lack of adequate official data and statistical instruments to quantify its real size and impact, but also the lack of an international consensus on what offshoring actually means.

In the absence of a commonly agreed definition of "offshoring" in the public debate or in the economic literature, the phenomenon has been frequently described as the process of relocation of services activities/functions to lower cost locations outside national borders.

From a microeconomic perspective, services offshoring is arising as an attractive business model to which companies increasingly resort in response to intensified global competition. By focusing on core activities and by outsourcing other tasks, firms may consolidate or enhance their competitiveness through specialization and more efficient organization, cost cutting, economies of scale and spreading risks. Essentially, offshoring of business processes by firms is not an entirely new phenomenon. Manufacturing firms have sourced components from other countries for many years. Also outsourcing of business processes within a country has existed in some form for centuries (UNCTAD, 2004; Kirkegaard, 2005). New are rather the forces which are driving offshoring in the present global economic setting, and subsequently its dynamics and scope.

From the perspective of the world economy, services offshoring appears to be a relatively new form of globalization, driven by mutually reinforcing technological, economic, institutional and organizational factors. It reflects an ongoing shift in the patterns of production and trade in services. It may be seen as a particular form of trade and FDI, enabled by increased tradability of services due to rapid advances in ICT in conjunction with liberalization of trade and FDI flows.

While the gains from services offshoring at company level are straightforward, i.e. enhanced competitiveness – due to lowering costs, increases in productivity and quality of services – its impact from a macroeconomic perspective is, however, less clarified. Hence, its implications in an economy-wide sense continue to be a subject of controversy. Especially its potential disruptive effects on employment in the developed countries continue to fuel concerns among policy makers and the broader public.

The new international division of labor emerging under the form of services offshoring is basically regarded as a win-win game. There is large agreement among economists that economic benefits – the outcome of specialization based on comparative advantage – are accruing to participants at both ends of the process. In conformity with the premise of standard economic theory, the efficiency and productivity gains achieved through offshoring in the long-term should enhance the overall growth and employment opportunities of both the home and host economies, provided they are capable to adjust. Yet it is also widely admitted that fast changes in international specialization may lead to tensions (especially due to displacement of workers), and may imply adjustment costs that governments, enterprises and individuals will have to bear. Just like all forms of international trade – whether in goods or services – offshoring is likely to bring about both winners and losers, with the key question for policy-makers being the design of proper policies to ensure that the former compensate the latter (van Welsum and Reif, 2006a).

3.2. Concepts, terminology and methodology

From the great variety of concepts used currently to describe the analyzed phenomenon we have opted for "offshoring" as the term most popularly used in the economic literature.[2] Further, we have adopted the definition provided by the OECD (2004, p. 89), according to which "services offshoring" is the international sourcing of *IT and ICT-enabled business services*, such as customer services, back-office services and professional services.[3] It may take two forms, namely:

(1) "*international outsourcing*", meaning the sourcing of a service from an independent supplier located abroad (i.e. unaffiliated trade); and

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[2] There is no commonly accepted terminology for describing the phenomenon. The terms used for its conceptualization differ greatly across authors, even though their meanings are often very close. Offshoring, outsourcing, offshore/international outsourcing, cross-border outsourcing, insourcing, inshoring, nearshoring, externalization, relocation, delocalization, production fragmentation, global sourcing, and global supply chain management – are some of the most frequently used terms.

[3] IT services encompass computer and related services. Cross-border ICT-enabled services (or *business process outsourcing* – BPO) are services provided from one country to another over telecommunication or data networks, and are either externally contracted or provided by a remote subsidiary of the same country.

(2) "*captive offshoring*", meaning the sourcing of a service from an affiliated firm abroad (i.e. through FDI, or affiliated trade).

Table 5 provides a rough picture of the most common offshored service activities. It reveals that the boundaries between IT and ICT-enabled business services (or *business process outsourcing* – BPO) are practically impossible to draw as the individual categories are often combined. Furthermore, there is in general no correspondence between the services that are being traded and existing statistical classifications of services. Hence, trade in offshorable services is hard to define and to quantify (Mattoo and Wunsch, 2004).

Table 5: Synopsis of offshored services

1. Information technology (IT) services (computer and related services)	
Software development and implementation services, data processing and database services, IT support services, application development & maintenance, business intelligence & data warehousing, content management, e-procurement and B2B marketplaces, enterprise security, package implementation, system integration, enterprise application integration, web services (Internet content preparation, etc.), web-hosting and application service providers, etc.	
2. Business process outsourcing services (BPO)	
2.1. Customer interaction services (typically performed by *call/contact centres*)	Technical and costumer support/advice, after-sales services, customer relationship management, employee enquiries, claims enquiries, reservations for airlines and hotels, subscription renewal, customer services helpline, handling credit and billing, telemarketing and marketing research services, etc.
2.2. Support services (back-office operations, typically performed by *shared services centres*)	Data entry and handling, data processing and database services, medical transcription, payment services, financial processing (financial information and data processing/handling), human resource/payroll processing, warehousing, logistics, inventory, supply chain services, ticketing, insurance claims adjudication, quality assurance, mortgage processing, etc.
2. 3. More independent professional or business services	Human resource services (hiring, benefit planning and payroll, etc.), financial and accounting services (including auditing, bookkeeping, taxation services, etc.), advertising, R&D, marketing, product design and development, architectural and engineering services, etc.

Sources: Mattoo and Wunsch (2004, p. 4); UNCTAD (2004, p. 159).

As there are no readily available statistical indicators for measuring the scale and dynamics of offshoring and its effects on trade, one has to rely on *indirect measures,* which serve as proxies. In order to gauge the phenomenon, BoP trade statistics will be used to identify emerging trends in the evolution and composition of Romania's trade in services, which might be put on account of increased offshoring. Starting point of the analysis is the assumption that a typical consequence of a decision taken at the level of a firm located abroad to offshore services to Romania should be a rise in the country's exports of services as it becomes the new location from which the services supplies are sourced thereafter.

Following a widely applied methodology internationally,[4] two service categories will be used to approximate the potential impact of offshoring on Romania's trade in services, namely: (1) "*computer and information services*" (CIS), and (2) "*other business services*" (OBS).[5]

The sum of the two BoP categories is assumed to cover the great variety of services that may potentially be affected by offshoring. Even though there are major pitfalls in the interpretation of trade data by linking them to different offshoring activities, BoP data have the advantage to help us highlight the dynamics and relative size of offshored services within Romania's total trade in services, and also allow us the calculation of net exports. However, given the shortcomings of trade statistics the interpretation of the results deriving from this kind of empirical exercise is liable to caveats.

4. Romania's Trade in Offshoring-related Services

4.1. How big are Romania's offshorable services flows?

In this section we aim to investigate if there is a rise in services offshoring in recent years as featured by Romania's BoP data on "other services" over 2004-2008. This BoP item covers the wide variety of business services which have been transformed due to ICT, and hence the type of services which bear relevance for offshoring, i.e. the "offshorable" services. These encompass "computer and information services" (CIS) and "other business services" (OBS), as defined in Section 3.2.

[4] See, *inter alia*: OECD (2004), Amiti and Wei (2004), WTO (2005), Stare and Rubalcaba (2005), van Welsum and Reif (2006a; 2006b).

[5] The "other business services" (OBS) category represents the sum of the following items of Romania's BoP: merchanting and other trade-related services; operational leasing services; other services (i.e. legal, accounting, management consulting, and public relations; advertising, market research, and public opinion polling; R&D; architectural, engineering, and other technical services; agricultural, mining; other business services).

Table 6: Romania's trade in offshorable services[1], in 1995-2008

	1995	2000	2001	2002	2003	2004	2005	2006	2007	**2008**
Offshorable services (CIS+OBS) – EUR million										
Credit	69	374	458	624	688	631	1,123	1,690	**2,358**	2,994
Debit	250	575	606	709	704	822	1,134	1,375	**1,481**	2,067
Net	-181	-201	-148	-85	-16	-191	-11	315	**877**	927
Share in total services trade (%)										
Credit	6.0	19.7	20.2	25.1	25.8	21.7	27.4	30.2	**34.0**	34.2
Debit	17.8	26.5	25.3	28.7	27.0	26.4	25.5	24.6	**22.9**	26.1

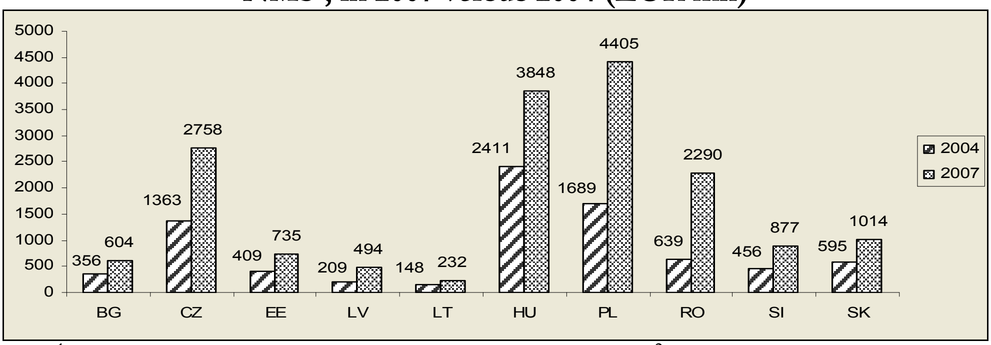
Note: [1] Offshorable services as defined in Section 3.2.

Source: Own calculations based on BoP Statistics, National Bank of Romania.

As seen in Table 6, the cumulative exports of offshorable services (CIS + OBS) amounted to EUR 2,994 million in 2008. Within this aggregate, exports of OBS represented EUR 2,397 million, while exports of CIS were notably lower, i.e. EUR 597 million. The corresponding cumulative imports stood at EUR 2,067 million in 2008 (out of which OBS represented EUR 1,563 million, and CIS EUR 504 million).

According to Figure 2, the recorded flows (in value terms) may seem rather small when compared with some of the NMS, particularly Poland and Hungary, but the growth of Romania's exports is quite impressive.

Figure 2: Exports of offshorable services[1] in Romania[2] and selected NMS[3], in 2007 *versus* 2004 (EUR mn)

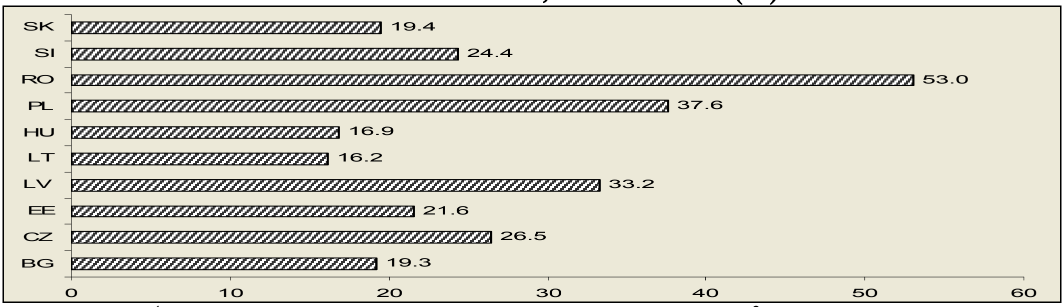


Notes: [1] Offshorable services as defined in Section 3.2; [2] 2007 Eurostat data for Romania (RO) do not coincide with 2007 data in Table 6, the latter being revised; [3] See Footnote 1.

Source: Calculations based on Eurostat data (Ghibuțiu and Poladian, 2008).

Indeed, Romania's offshorable services exports (CIS + OBS) accelerated spectacularly over the 2004-2008 period (see Table 2). Their growth (CAGR) peaked at 48%, surpassing considerably that of both total services exports (32%) and goods exports (15%). Growth on the import side (26%) lagged markedly behind the expansion rate of exports, being roughly in line with that of total services and goods.

Figure 3: Growth (CAGR) of offshorable services[1] exports in Romania and selected NMS[2], in 2004-2007 (%)



Notes: [1] Offshorable services as defined in Section 3.2; [2] See Footnote 1.
Source: Calculations based on Eurostat data (Ghibuțiu and Poladian, 2008).

As illustrated by Figure 3, Romania ranked first among the NMS in terms of offshorable services exports dynamics over 2004-2007, followed by Poland and Latvia. Yet, when contemplating this strong export growth, it is important to keep in mind that Romania, like many other countries worldwide with similar export dynamics and often mentioned as low-cost locations for offshored services, is growing from a very low level, and some of the rapid growth may be explained by economic development.

Owing to the extraordinary export growth performance, the combined share of the two offshorable services categories in Romania's total services exports increased from 22% in 2004 (6% in 1995) to 34% in 2008 (Table 6). Comparatively, the respective share represented 36% for the EU-15 in 2007.

Finally, noteworthy changes occurred as regards the contribution of the offshorable services categories to the country's trade performance. At the aggregated level, these services have fuelled permanently Romania's chronic services deficits until 2006, when they generated for the first time net exports of EUR 315 million, which augmented to EUR 877 million in 2007 and EUR 927 million in 2008 (Table 6). Actually, they have contributed significantly to the first major surpluses recorded by the "other services" item of the BoP after 1990 (Table 4). It follows, that the favourable trend reversal in terms of overall services balance is largely attributable to net exports generated by the offshorable services categories.

From the above analysis it may be concluded that trade in offshorable services has clearly gained momentum over 2004-2008, which might reflect highly dynamic offshoring activities hosted by the Romanian economy. Moreover, the remarkable expansion of offshorable services exports has been accompanied by favourable developments in terms of net trade.

While these findings are supportive of the supposition that offshoring has generated more trade flows in Romania, not all trade in these services categories is related to this process, and nor is it possible to distinguish which part of it is (van Welsum and Reif, 2006a). However, the resulting trade might be seen as an upper limit for the estimated value of offshored services (WTO, 2005).

4.2. How Competitive Is Romania?

A combination of cost-related and non-cost factors, including relatively low labor costs, availability of highly skilled and multilingual workforce, modern ICT framework, is behind Romania's intrinsic advantages as desirable target of companies' offshoring decisions. Geographical proximity to EU-15 markets, linguistic traditions, historical ties and cultural affinity are further enhancing its competitive advantage over popular low-wage locations in Asia or other parts of the world. There is no doubt, however, that EU accession is the primary driver of Romania's current attractiveness, even though full EU membership will bring about an erosion of its cost advantages in the long-term.

The key question to be answered in the present chapter is how well is Romania suited to cope in the rapidly changing environment where the new competitors that have emerged across the world (e.g. India, China, Malaysia, Thailand, Brazil, etc.) hold a broad array of comparative advantages in high value-added services industries. Since the emerging economies and Romania share specialization patterns in areas of services trade with similar skill and factor intensities, the former are strong competitors for the latter. But apart from competition from low-wage economies, Romania is also confronted with growing competitive pressures from the other NMS in the context of EU enlargement. Moreover, it may be argued that competition across the NMS is even more pronounced, as they are competing in the same range of services, and present large similarities in respect of location-related advantages. Mainly for this reason, but also due to lack of comparable data, our attempt to evaluate Romania's competitiveness in the global offshoring market focuses on the country's competitive strength relative to the NMS grouping.

What follows is an assessment of Romania's competitiveness based on Eurostat data, by applying the classic Balassa "revealed comparative advantage" (RCA) to the offshorable services categories (Balassa, 1965). The RCA index is defined as the ratio of Romania's offshorable services exports to its total services exports divided by a similar ratio for the NMS as a group. An index above unity indicates that the country is relatively specialized in these services, a result which is interpreted as an indication of comparative advantage.

Table 7: RCA indices in offshorable services[1] for Romania and selected NMS[2], in 2004 and 2007

		BG	CZ	EE	LV	LT	HU	PL	RO	SI	SK
CIS + OBS	2004	0.57	0.95	0.97	0.78	0.40	**1.70**	0.81	**1.21**	0.89	**1.08**
	2007	0.56	0.98	**1.01**	0.79	0.33	**1.49**	0.90	**1.36**	0.93	0.91
CIS	2004	0.33	0.66	0.66	**1.19**	0.62	**1.64**	0.63	**1.99**	**1.37**	**1.55**
	2007	0.58	**1.24**	**1.00**	0.84	0.20	**1.33**	0.64	**2.00**	0.83	0.89
OBS	2004	0.61	0.99	**1.02**	0.73	0.37	**1.71**	0.83	**1.12**	0.83	**1.03**
	2007	0.55	0.94	**1.01**	0.79	0.36	**1.51**	0.94	**1.27**	0.94	0.92

Notes:[1] Offshorable services, CIS and OBS as defined in Section 3.2;[2] See Footnote 1.
Source: Calculations based on Eurostat data (Ghibuțiu and Poladian, 2008).

Table 7 displays the resulting RCA indices for 2004 and 2007 both for total offshorable services and the two components, which are assumed to reflect Romania's competitiveness relative to the NMS as a group. Accordingly, it may be observed that Romania (along with Hungary and Estonia) reveals a comparative advantage in total offshorable services in 2007, and is experiencing an upward move compared to 2004.

However, it is important to note, that competitiveness indicators calculated on the basis of cross-border trade flows as measured by BoP data are less relevant in services than in goods given that there are other three modes of supplying services internationally under the GATS framework, i.e. consumption abroad, commercial presence and movement of natural persons,. Hence, the results of the above exercise should be interpreted with due caution.

5. Romania's Increasing Attractiveness as Host Country for FDI-related Offshoring

As mentioned above, not all trade in the offshorable services categories estimated on the basis of BoP statistics is related to the offshoring phenomenon, and nor is it possible to distinguish which part of it is. Further, both forms of offshoring, i.e. *international outsourcing* (on a contractual basis) and *captive offshoring* (through FDI) are presumed to appear in the BoP trade statistics, as unaffiliated trade and affiliated trade respectively. However, the current BoP statistics do not permit us to divide cross-border transactions between affiliated and non-affiliated firms.

The argument that offshoring under both forms has accelerated over the last years, and generated increased services exports is backed up not only by BoP trade statistics but also by a large amount of company-level data. For instance, survey-based data on Romanian IT services companies provide ample evidence for the rapid pace of *international outsourcing* over 2006-2008 as compared to the early 2000s.

On the other hand, FDI plays an important role in services offshoring.[6] According to estimates by McKinsey&Company (2005), over two-thirds of all services offshoring globally takes place under the form of *captive offshoring*, i.e. through FDI. But, similarly to trade, FDI statistics are not adequately equipped to measure offshoring, and hence to determine what share of FDI is directly linked to it.

Services-related FDI inflows into Romania have followed broadly the trend of growth in services worldwide and in the CEE region itself, but with a notable delay. While in the largest FDI recipient countries – Poland, the Czech Republic and Hungary – services had already become dominant in FDI in the late 1990s, the structural change in Romania has been considerably slower, with manufacturing

[6] In the FDI literature, offshoring is identified as efficiency-seeking FDI, as opposed to market-seeking FDI. Alternatively, export-oriented subsidiaries are set up by vertically integrated multinational companies in a host country with the aim to lower production costs or to seek, secure and diversify resources (Hunya and Sass, 2005). As services become more open to efficiency-seeking FDI, information-intensive services can be fully subjected to the international division of labor and hence integrated international production.

retaining a much higher share of FDI.

FDI in business services played a relatively limited role until recently, and Romania's involvement in export-oriented FDI projects was insignificant. The results of an examination by UNCTAD (2004) of the number and destination of TNC projects worldwide in export-oriented services in 2002-2003 may be used as a proxy to illustrate the country's low attractiveness for offshored services. According to this quantitative assessment, TNC projects related to services offshoring in the CEE over the respective period have been concentrated in Hungary (26 projects), the Czech Republic (20 projects) and Poland (15 projects). Romania received only 7 projects, out of which 4 concerned *regional headquarters*, 2 projects *IT services*, and 1 project *call/contact centre services* (front-office services). Very interestingly, no project related to *shared services centres* (back-office services) went to Romania in the respective period, while Hungary received 7, the Czech Republic 6 and Poland 5.

Unfortunately, there are no comparable data on global TNC projects in export-oriented services for the more recent period, when Romania's offshorable services exports increased significantly according to BoP data. Yet we may get some relevant insights into the dynamics and extent of offshoring-related developments from combining official FDI statistics and alternative sources of information.

5.1. What do the official FDI statistics tell us?

The highly dynamic FDI-related developments in the last years suggest a notable rise in Romania's attractiveness as target of offshoring decisions by TNC, and support the view that captive services offshoring has also gained momentum compared to the early 2000s.

The outstanding growth of FDI inflows over the recent years has no precedence. Average annual FDI inflows increased over 4.7 times during 2004-2007 as against 2000-2003. After the turnaround in 2004, FDI rose sharply and reached its highest level ever in 2006 (EUR 9.1 billion), being followed by FDI inflows worth EUR 7.3 billion in 2007 and 9 billion in 2008, according to data by the National Bank of Romania (NBR, 2009). As a result, Romania's total inward FDI stock rose to EUR 47.2 billion in 2008, equivalent to a 3 times increase compared to 2004.

It may be argued that at least partially the increased amounts of FDI are attributable to enhanced offshoring activities unfolding between Romania and companies from the EU and the rest of the world. The sheer fact that over 80% of Romania's inward FDI stock is accounted for by investors originating from the EU is indicative of the high level of corporate integration and intense offshoring activities between the country and the old EU member states.

Further, changes in the industrial composition of Romania's inward FDI stock over the 2004-2008 period point to intensified services-related FDI inflows. Available data on the sectoral breakdown of FDI stock reveal an expansion of TNC in the services sector, and particularly in business services. While manufacturing still accounted for 48% of Romania's total FDI stock by the end of 2008 (down from 56% in 2004), the cumulative share of services industries augmented from 43% in

2004 to 51% in 2008. Moreover, business services – which cover those areas that are prone to offshoring, including computer activities, R&D, and other business activities – increased the respective share from 17% in 2004 to 26% in 2008 (National Trade Register, 2004; 2009).

The above figures provide support for the view that increased amounts of FDI directed towards business services might be attributed to intensified offshoring. However, these figures alone do not offer any point about the current level of FDI that is directly related to services offshoring. Therefore, to take a step further our investigation, we provide some additional information from alternative sources, both official and private.

5.2. What do the alternative sources tell us?

A clear evidence that the recent upsurge in FDI flows went hand in hand with the dynamic expansion of captive offshoring is provided by The Romanian Agency for Foreign Investment (ARIS), which is responsible for monitoring major FDI projects and providing consultancy to foreign investors.

According to ARIS (2007), out of the total 24 FDI projects assisted and monitored during 2006 (with EUR 470 million overall investment value and 6,060 new jobs), 5 projects involved offshored services centres set up in Bucharest by Hewlett Packard, Microsoft, General Electric, Infineon and Wipro. These projects represented 21% of the total number of successful projects monitored by ARIS in 2006, and accounted for 32% and 45% of the total investment value and new jobs, respectively. These figures are all the more relevant as out of the 21 FDI projects assisted and monitored by ARIS during 2004-2005 (with EUR 471 million total investment value and 11,655 new jobs) none was related to services offshoring.

Additional information confirming the steady rise of captive offshoring over the recent years in Romania comes from company-related media reports, which remain basically the main source for monitoring the real trends in offshoring activities. Even a snapshot on media information reveals the surge of offshoring-related FDI projects in Romania since 2006, and the presence of several global players on the local offshoring market, including the top 10. For instance, during the first six months of 2006 only, three major global players set up almost simultaneously their business process operation centres (BPO) in Bucharest, namely Hewlett-Packard, Oracle and Microsoft.[7] The total number of BPO-related FDI projects that have become operational in 2006 alone amounted to 6, which is a testimony to the country's increasing attractiveness (IDC, 2007). This is all the more relevant as out of the 7 offshoring-related FDI projects oriented towards Romania in 2002-2003 (as revealed by the UNCTAD assessment mentioned above) none concerned shared services centres.

[7] Actually, foreign companies' interest in the Romanian market has become evident particularly since 2006, when Computer Generated Solutions (CGS), the American group specialized in IT services outsourcing, acquired the largest local company (Easy Call).

According to various media reports, offshored services centres continued to grow at an astonishingly rate also during 2007-2008, and Romania established itself as a prime location for offshored services, particularly for clients based in Western Europe and the United States. But call/contact centres that provide customer interaction services have been also springing up steadily. By mid-2008, their number reached 250-300, rising by 10-20 units per year. The market for call centres was evaluated at EUR 70 million in 2007, and EUR 120 million in 2008 (EUR 30 million in 2006). According to XL World, a major player, it is likely to grow by 500% in the next five years.

It is also noteworthy that companies providing IT and BPO services have been the most active employers in the Romanian economy between 2006 and 2008, with their rate of recruitments being faster than in any other traditional industry.

Professionals from the offshoring business expect the local market (BPO and call centres) to expand significantly in the near future. According to estimates (released in mid-2008), its size will reach EUR 350-500 million by 2013. This seems to be in line with the argument put forward by Hunya and Sass (2005), according to which the scope for further expansion of efficiency-seeking FDI in the NMS is still wide. Actually, most of the TNC active on the Romanian market started as market-seeking FDI already in the 1990s, and expanded later into efficiency-seeking FDI, including export-oriented projects.

6. Concluding Remarks

Over the past few years, Romania's trade in services has recorded outstanding growth rates, particularly on the export side. Moreover, the dynamic expansion of trade flows has been accompanied by an accelerated pace of structural changes.

The findings of the paper back up the view that the remarkable export growth over the 2004-2008 period, coupled with the favourable shifts in the structure and performance of services trade has been largely driven by globalization, i.e. enhanced offshoring activities hosted by the Romanian economy.

Piecing together the scattered information derived from official statistics and private sources, our empirical work provides clear evidence that offshoring has gained momentum in Romania compared to the early 2000s, under both its forms: international outsourcing and captive offshoring. Its findings also confirm media reports and projections put forward by international consulting companies on the country's growing attractiveness as location for companies' international organization of production.

While notable differences continue to exist between the "old" NMS (like Poland, the Czech Republic, and Hungary) and Romania (traditionally epitomized as a "laggard") in terms of export capabilities in services and competitive strength, a fast catching-up process is discernible in the latter. Moreover, the findings suggest that Romania is stepping forward to seize more and more of the global offshoring business, and is establishing itself as a favourite target of offshoring decisions by companies originating both inside and outside the EU-15.

While cost-related as well as non-cost factors are lying behind Romania's intrinsic advantages as location for offshored services, there is no doubt that its current attractiveness is associated with accession into the EU. Yet it is also true that full EU membership is likely to bring about an increase in the cost of doing business, and a subsequent erosion of the country's cost advantage. That these trends are already at work is confirmed by A. T. Kearney's (2007) country assessment, according to which Romania's competitiveness in the global services offshoring market diminished in 2007 as against 2005, due mainly to rising costs and lower availability of skills.

Services offshoring like globalization in general brings both economic benefits and costs to the countries implied. The benefits accruing to host countries illustrate the classic gains from trade and specialization: expansion of trade flows, increase of economic activity through the operations of TNC subsidiaries, creation of new jobs, transfer of soft technology, increased competition and higher quality services.

Our findings support the view that Romania has so far benefited from globalization, and the benefits outweighed the costs at least from a trade perspective. Firstly, services offshoring generated more trade, primarily in new and advanced types of services. Secondly, it exerted a positive impact on the composition of services supplied internationally, by expanding the share of high value-added services. Thirdly, Romania's net position in business services moved from chronic deficits to growing surpluses, suggesting that the country is beginning to move up the value-added chain. And last but not least, increased business services exports helped to improve Romania's external financial position. These exports have triggered a historical trend reversal in total net trade in services, by turning structural deficits into surpluses. On the downside, increased offshoring might lead in the long-run to growing services imports and income transfers of TNC to their home countries, bearing additionally upon Romania's already large current account deficit.

Finally, the findings of the paper bring us to the following question: Should Romania try and build competitiveness in trade in IT and ICT-enabled services? Our answer is a definitely "yes". However, the export of services as such should not be seen as the final goal. Such exports are conducive to economic development in a broader sense, because they generate not only international trade and FDI flows as well as new jobs, but are also supporting the competitiveness of the economy as a whole. Due to growing services-intensity of all economic activities, the competitiveness of firms in open economies is determined increasingly by access to low-cost and high-quality business services. As business services are key inputs in all economic activities, and are also major agents for the diffusion of new ICT and skills throughout the economy, they are decisive for upgrading all productive activities. And last but not least, business services exports can improve the international image of Romania and support, implicitly, the country's exports of goods.

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