

The Effects of Offshoring on Trade in Services. Evidence from Romania

Agnes Ghibutiu*

Irina Dumitriu**

Abstract

Relying on insights from theoretical and empirical contributions on the issue of services offshoring, the paper explores the possible effects of offshoring on Romania's trade in services, by looking at its evolution during the 1995-2006 period in terms of dynamics, composition and balance. Given the multiple shortcomings of both statistical data and instruments available currently for tracing and measuring offshoring activities, the paper adopts a three-tier approach – based on official trade statistics, official FDI data and additional information from different private sources – to find evidence for enhanced services offshoring in Romania. The results of the empirical investigation underpin our assumption that the remarkable growth rates of exports in some individual services categories and the positive changes emerging in the patterns of Romania's trade in services are largely attributable to intense offshoring activities associated with the growing presence of TNCs in the Romanian economy. Concurrently, the findings of the paper confirm that anecdotal evidence on the country's rising attractiveness for offshored services is supported by official statistics, even though the interpretation of the final results remains subject to caveats. An examination of the current and future potential of Romania as location for services offshoring in the European and global context is closing our discussion, followed by conclusions and some policy considerations.

Key words: trade in services, FDI, offshoring, Romania

JEL classification: F14, F21, F23, L80

* Senior research fellow, Institute of World Economy, Bucharest. E-mail: agnesghibutiu@clicknet.ro

** Business consultant and associated professor, Academy of Economic Studies, Bucharest.

E-mail: dbirina@yahoo.co.uk

Introduction

Over the last couple of years, services offshoring ranked among the most intensely debated topics in the context of international economics. The highly dynamic developments revolving around this phenomenon continue to widely focus the interest of economists and politicians, as well as the public at large.

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 (especially low-wage) locations outside national borders. By assuming the perspective of the country of origin, such a description contributed largely to portraying services offshoring as a one-way process from developed countries to developing and transition countries, by which the former would be greatly affected. Especially the potential threat of services offshoring to employment gave rise to considerable concern among policy makers and the broader public in the home countries, mostly high-wage developed countries. To a large extent, the anxiety has been fueled by the great number of alarming media reports, released in an earlier stage, by private business consulting firms and industry associations on the allegedly huge job losses accruing to these countries.

The growing number of theoretical and empirical contributions in the last years has shed more light on the multifaceted topic of offshoring. By and large, the new insights gained from research have contributed to a better understanding of the nature of services offshoring, its driving forces and dynamics as well as its impact. And most importantly, they have been helpful in channelling the initially heated debate on a less emotional track and in placing the expectations and fears of offshoring into a more balanced perspective.

The one-sidedness of approach prevailing in the ongoing debate on offshoring – i.e. as an one-way process typically from a high-wage location to a low-wage destination from Asia or Eastern Europe – explains to a large extent why the bulk of academic research has focused so far on the potential employment effects of services offshoring in developed countries.¹ Far less empirical contributions have been devoted to investigating its trade effects.² Particularly scarce is systematically led academic research on the impact of services offshoring in the host countries, and specifically in the new EU member states (NMSs).³ This is in sharp contrast to the large amount of recent estimates by international consulting firms, which are viewing the NMSs as increasingly attractive locations for services offshoring both in the European and the global context. Nevertheless, a general consensus seems to emerge in the literature and among the experts, that European enlargement has rendered NMSs increasingly desirable targets for services offshoring.

Until very recently, Romania did not rank among the most attractive offshoring locations worldwide. Moreover, the country’s involvement in export-oriented global FDI projects related to offshored services (call centres, shared services centres, IT services, etc.) was rather insignificant compared with other NMSs, e.g. Hungary, the Czech Republic or Poland.

During the last two years, Romania has caught increasingly the attention of media reports both domestically and internationally for its high potentiality as host country for offshored services. Particularly its vast talent pool and modern ICT frameworks are considered to make it a leading player in Eastern Europe. Moreover, Romania is now

seen by some analysts as becoming “Europe’s India” in terms of offering offshoring solutions to the rest of Europe.⁴

Evidently it is quite exaggerated to relate Romania, or any other East European country, to the Indian model, despite their increasing attractiveness. Due to its low labour costs and availability of huge human resources with technical and language skills, India has been the worldwide success story of offshoring over more than a decade, and still continues to be the world’s most famous and attractive location for companies seeking to open services offshoring centres. Not only that in Eastern Europe the labour market is much more fragmented, but there are many other factors which make such a comparison irrelevant and unsustainable.

Against this background of huge expectations, our paper attempts to disentangle the real facts behind the hype. It represents a first step in the analysis of the impact of services offshoring in the case of Romania. Its aim is to piece together the scattered available evidence on services offshoring into an overall picture on the dynamics, scale and characteristics of this phenomenon, and to assess the extent to which the resulting picture is consistent with the image conveyed by anecdotal evidence.

Section 1 lays out the starting point of the analysis, by giving a brief summary of the main insights into the offshoring phenomenon emerging from the current literature on the topic. It then goes on to define what in the paper is meant by “services offshoring” and to set out the methodology underlying the analysis, including the description of the data used to measure it. Relying on official trade statistics complemented by company-level data, Section 2 documents a set of features about Romania’s trade in services in terms of dynamics, composition and balance which might be relevant for enhanced services offshoring. In Section 3, available official data on FDI as well as proxies will be used to underpin the observed trends in trade in services. This section will then try to integrate the findings from official data into a broader picture by relating them to unofficial sources of information. Section 4 investigates the current and future potential of Romania as location for offshored services activities, and highlights its strengths and weaknesses. Section 5 concludes with some associated policy considerations.

1. The Framework of Analysis

1.1 Brief review of the main findings from research

According to a recent remark by Kirkegaard (2007), “few new topics in international economics have risen faster to the top of the political agenda, while simultaneously so poorly understood and quantified, than outsourcing in recent years”.⁵ Indeed, despite ranking high on the media and policy agendas, 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 the unavailability of adequate official data and statistical instruments to quantify its real size and impact, but also by the absence of an international consensus on what offshoring actually means. Lack of progress in harmonising internationally the definitions, data classifications, as well as data collection itself, greatly restricts the scope for comparison of the various studies on the extent and

effects of services offshoring and, implicitly, the formulation of consistent policy recommendations.

A brief review of the main insights emerging from the literature on the topic may provide both a good starting point and a general background for the analysis on the implications of services offshoring in the context of the Romanian economy.

First of all, when approaching the services offshoring phenomenon, it is important to take account of its multifaceted nature, and consequently to keep distinct its microeconomic, macroeconomic and global dimensions.

Adopting a *firm-level view*, 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 specialisation and more efficient organisation, cost cutting, economies of scale and spreading risks (OECD, 2004). Essentially, offshoring of business processes by firms is not an entirely new phenomenon. Manufacturing firms have sourced components from other countries for many years, while the outsourcing of business processes within a country has existed in some form for centuries (UNCTAD, 2004; Kirkegaard, 2005). New are however the forces which are driving and shaping services offshoring in the present global economic setting, and subsequently its dynamics, the forms it may take, as well as its scope.

Seen from a *world economy perspective*, there is a largely converging view in the current literature that services offshoring reflects an ongoing shift in the patterns of production and trade in services, with wide-ranging consequences for the international division of labour. As such, it is a relatively recent development in the global landscape, i.e. a new form of globalisation, driven by mutually reinforcing technological, economic, institutional and organizational factors. It is associated especially with the globalisation induced by the new information and communication technologies (ICTs).

More specifically, services offshoring may be seen as a *particular form of trade*, enabled by increased tradability of services, due to rapid technological advances in ICTs (IT systems, broadband communications and Internet) in conjunction with liberalisation of trade and FDI in services, autonomously as well as at the regional and multilateral level. As a result, services activities are now less constrained in their choice of location than they have been traditionally, meaning that many types of service categories that were previously only tradable through the movement of provider (i.e. through face-to-face contact) can be now supplied from remote locations. For many firms in all sectors this means that the production of various ICT-enabled services may be “outsourced”, i.e. turned over to other specialized companies. And if it can be outsourced, then it can generally also be offshored (Kirkegaard, 2005). Moreover, by fragmenting the production of entire ICT-enabled services (or parts thereof) internationally – in locations situated outside the firms’s home countries – in line with the comparative advantages of different locations and the competitiveness-enhancing strategies at the firm level – companies can gain economies of scale from consolidating and standardizing their services activities across the globe (UNCTAD, 2004). While ICTs and continuing efforts to liberalise trade and FDI have made services offshoring feasible, the emergence of a global labour market for skilled workers – with a quite large number of developing and transition countries characterized by relative abundance of skilled labour, available at a relatively low wage –

turned services offshoring into a profitable way of doing business in an increasingly competitive global environment.

Although there is no commonly agreed-upon definition on services offshoring, and nor are there direct official data measuring the extent of this phenomenon, it is generally believed that it has the potential to grow substantially. While estimates on its size and dynamics vary significantly, they are converging in the assertion that the process is still in its infancy, and it will continue to expand dynamically over the coming years. Moreover, the process is likely to accelerate as its benefits become more evident, technologies improve and more companies and countries join the early movers (UNCTAD, 2004).⁶

As regards the impact of services offshoring, it is largely admitted among analysts that it has production, employment and trade effects on home countries and host countries alike. While the gains from services offshoring at the firm 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, to a lesser extent clarified.

Hence, its implications in an economy-wide sense, both its real benefits and losses, 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, yet to a far lesser degree among economists. Actually, the findings arising in the last few years from the impressive number of contributions devoted to the empirical investigation of the labour market-effects of services offshoring in the high-wage countries point to its limited impact. These results support, implicitly, the conclusion drawn earlier by Amiti and Wei (2004), according to which “the risk of services offshoring dramatically reducing job growth in the advanced economies has been greatly exaggerated”.⁷ It is also important to note, that several recent studies supported by new statistical information have emphasized the relatively modest size of services offshoring if viewed from a macroeconomic perspective. Even though the figures on annual growth rates of services offshoring put forward by different media reports from private sources might look spectacular, when related to total inflows and outflows in the relative labour markets, or to total services trade, the figures seem to be far less impressive.

Finally, the new international division of labour which is emerging under the form of services offshoring is now basically regarded as a *win-win game*. There is large agreement among economists so far that the economic benefits – the outcome of specialization based on comparative advantage – are accruing to participants at both ends of the process.⁸ Host countries are considered to gain in terms of employment, upgrading of skills, capital inflows, technology transfer and increased trade flows, including the opportunity to enter new industries before domestic demand can support them. Home countries are seen to benefit from enhanced competitiveness, enlarged access to cheap and high-quality services, and the opportunity to move up the skill and technology ladder. Yet it is also largely admitted that fast changes in international specialization may lead to tensions (notably 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 at the level of individuals, firms and countries, with the key

question for policy-makers being the design of proper and consistent policies to ensure that the winners compensate the losers.⁹

Against this brief picture of services offshoring from a global perspective, the question then becomes, just what are the trends, characteristics and drivers shaping the offshoring landscape in Romania as a host country?

1.2 Terminology and methodology

Starting point of our 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 service supplies are sourced thereafter. Before moving to the analysis, we will provide the terminology as well as the methodology underlying the analysis in the paper.

1.2.1 Definition

In order to clarify the scope of “offshoring” and delimit the forms it may take in our discussion, we first define what in our paper is meant by “offshoring”.¹⁰ From the great variety of concepts used currently, we have opted for “offshoring” as the term most popularly used so far in the economic literature.¹¹ Further, we have chosen to rely on the definition provided by the OECD (2004, p.89), as it seems to be the most adequate for our investigation. Accordingly, we understand by “services offshoring” the international sourcing of IT and ICT-enabled business services (such as customer services, back-office services and professional services), under its both forms, i.e.:

- “international outsourcing”, by which we mean the sourcing of a service from an independent supplier located abroad (third-party service provider) (i.e. unaffiliated trade); and

- “captive offshoring”, by which we mean the sourcing of a service from an affiliated firm abroad (i.e. FDI and intra-firm sourcing, or affiliated trade).

We will use the generic term “offshoring” throughout the paper, unless otherwise specified.

1.2.2 Methodology

It is largely acknowledged that official statistics are not adequate for comensurating the extent and dynamics of services offshoring. It is not only that statistics cannot keep pace with the highly dynamic developments related to offshoring, which is a phenomenon at the firm level, but the current statistical system itself makes any meaningful measurement difficult. Major shortcomings related to the current statistical systems are arising from the absence of a commonly agreed-upon definition on offshoring, the multitude of forms offshoring may take, the lack of concordance between the current definitions and the existing statistical concepts and classifications of industries and officially collected data.¹² Therefore, in our attempt to gauge the evolution and extent of services offshoring in Romania, and particularly its effects on the country's trade in services, we will adopt a three-tier approach.

Firstly, we will rely on BoP trade statistics and derived official data (proxies) to identify emerging trends in the evolution and composition of Romania's trade in services, which might be put on account of increased offshoring.

Secondly, we will try to trace evidence for increased offshoring in Romania on the basis of available official FDI data, i.e. BoP statistics and data from the National Trade Register. This investigation is aimed at complementing the insights gained from trade statistics, especially as according to estimates services offshoring takes place predominantly through captive offshoring.

Thirdly, we will confront our findings in terms of official statistical data with evidence derived from different private sources, which are useful in catching those early emerging developments that the official statistics are not yet equipped to reflect or do report with great delay respectively. Such additional sources of information include: media reports, surveys and reports from private sources, market research and case studies, estimates by industry experts and consultants, including international consulting companies. Even though these vary in their reliability and their conclusions, when put together, they are likely to provide supplementary information on the dynamics and extent of services offshoring in Romania.

1.2.3 Description of data and measurement-related problems

Trade data

The main data source we use to investigate the patterns of Romania's trade in services in terms of offshoring is the national balance of payments (BoP). These data record transactions between a resident of Romania and a resident of another country. Both international outsourcing and captive offshoring may be expected to appear in the BoP trade statistics, as unaffiliated trade and affiliated trade respectively.

As there are no readily available statistical indicators for measuring the extent and dynamics of offshoring and its effects on trade, we will rely on *indirect measures*, which serve as proxies. Following a widely applied methodology internationally¹³ we will use two services categories to approximate the potential impact of offshoring on Romania's trade in services, respectively: "*computer and information services*" (CIS) and "*other business services*" (OBS) (which we will also refer to as just "business services").

The sum of these two BoP categories is assumed to cover the great variety of services that may potentially be affected by offshoring. Further, this aggregate is considered to contain information on international outsourcing and captive offshoring combined. Appendix Table 1 provides a detailed description of the services included under the two headings.¹⁴ In the current literature, these two categories are also frequently referred to as *IT services* and *ICT-enabled services* respectively. The latter are also known as *business process (outsourcing) services* – BPO.¹⁵ We will use this terminology too, as we will use the term "*offshorable services*" to generically refer to the sum of the two categories of services.

While according to our assumption, offshored service activities should result in a trade flow in services, not all trade in services is related to offshoring and nor is it possible to distinguish which part of it is. Similar problems apply to the analysis of FDI as it is not possible to determine what share of FDI is directly related to offshoring (van

Welsum and Reif, 2005). However, we consider the resulting trade as an upper limit for any estimated value of offshored services (WTO, 2005).

We have to recognize along with other analysts, that there are major pitfalls in the interpretation of BoP trade data by linking them to different offshoring activities. Apart from the fact that offshoring cannot be equated to trade in services, as not all trade in services is related to offshoring, there are also other problems that must be taken into account. Firstly, BoP statistics combine international outsourcing and captive offshoring, and include both non-affiliated and affiliated trade. However, the Romanian BoP statistics do not allow us to divide cross-border transactions between affiliated and non-affiliated firms, given the fact that the country did not implement yet the foreign affiliates trade in services statistics (FATS).¹⁶ Secondly, limiting our attention only to cross-boarder trade as measured by the BoP data is inappropriate given the fact that some of it is also related to FDI and temporary migration of labour (mode 3 and mode 4 respectively of supplying services internationally under the GATS), which are not captured by current BoP trade data.¹⁷ Thirdly, trade with affiliates can pose several sectoral classification problems. Depending on the sectoral allocation of a firm, the same services flows (e.g. IT services) may be allocated either to IT services or to categories of services (e.g. insurance or banking services), which we did not consider in our analysis as “offshorable”. This means implicitly an underevaluation of the amount of “offshorable” services considered in the paper. Fourthly, a whole range of IT and IT-enabled services exports by small firms or individuals (e.g. freelancers) might be not reported at all. And last but not least, the quality of the data may be affected by factors such as reporting difficulties, differing collection methods, and last but not least the complexity of the structures and operations of multinational firms. The situation is even more complicated in Romania, which started upgrading its statistical system only recently, and where official statistical data collection is still in its infancy, particularly in those domains which are the most relevant to gauging offshoring – i.e. services sectors and TNCs data.

Nevertheless, BoP data have the advantage to help us to highlight the dynamics and relative size of IT services and ICT-enabled services within Romania’s total trade in services, and also allow us the calculation of net exports.

FDI data

Obviously, FDI plays an important role in services offshoring, affecting it in two ways: through captive offshoring, and when specialized services providers set up foreign affiliates to serve foreign clients. However, the role of FDI in offshoring is difficult to quantify. Similarly to trade, FDI statistics are not adequately equipped to measure services offshoring. We will try, however, to get some insights into the dynamics and extent of this process from combining several sources of information, i.e.:

- official FDI statistics based on BoP and on data from the National Trade Register (for sectoral breakdown and countries of origin), which may convey at least a rough picture of the trends underlying the evolution of FDI inflows in terms of magnitude, dynamics and industrial composition;
- proxies (e.g. the examination of the number and destination of export-oriented projects worldwide, provided by UNCTAD for the 2002-2003 period, which highlights the dynamics of services offshoring);

- company-level data and company-related reports.

As in the case of trade, the shortcomings of FDI statistics for gauging offshoring are manifold. First of all, not all FDI represent offshoring. Besides, the existing industrial classification systems do not allow for capturing the value of all offshored services projects. In addition, investments related to offshoring typically do not generate large capital flows, and therefore do not account for large shares in the FDI statistics. Further, FDI statistics cannot capture offshoring in all its dimensions i.e both captive offshoring and international outsourcing, because: on the one hand, international outsourcing (i.e. outsourcing to independent companies) does not generate in principle FDI (hence, FDI-related statistics are irrelevant); on the other hand, it is hardly possible to identify captive offshoring, which is related to FDI in vertically integrated, export-oriented subsidiaries (Hunya and Sass, 2005).

Hence, it has to be kept in mind that the interpretation of the results deriving from our analysis based on trade and FDI data is liable to the usual caveats associated with this kind of empirical exercise.

2. Romania's Trade in Services

A short insight into the main characteristics of Romania's trade in services during the transition is necessary before highlighting those newly emerging trends in its patterns which we assume to be related to increased services offshoring, and which bear relevance for the country's potential for offshoring.

2.1 The legacy of the past

The previous economic system left Romania with one of the most depressed services sectors and the longest paths towards a services-oriented market economy, for which it was the least equipped among the former communist countries in the region. In a highly centralized 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 was severely restricted until 1990 (Ghibutiu, 1999). Moreover, services have been relegated to a status of lesser importance in the development process both in terms of theory (ideology) and economic policy. Subsequently, 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).

Consequently, when Romania started to move towards market-oriented policies and institutions, a wide range of service categories, particularly business-related services (such as banking and insurance, telecommunications, computer and information services etc.) were either nonexistent at all or not developed according to Western standards. No wonder that at the beginning of the transformation process Romania ranked among the least services-oriented economies from Central and Eastern Europe (CEE). And it may be argued that in respect of several services categories, development started practically from scratch.

The process of market-building and market-functioning demanded increasing amounts of business services, particularly professional services, including legal services, accounting and auditing, advertising, market research, management consulting etc. However, in the first years of transition these services could not be provided locally due to lack of expertise and skills, particularly business management skills and marketing know-how, but also owing to shortage of capital and weak telecommunications infrastructure. Hence, they had to be acquired from abroad, either from individual practitioners or specialized firms from Western countries. Foreign investors have acted as pioneers in the domestic market, opening and showing the way for developing several new business service categories and, implicitly, in spurring the emergence of local business services companies. Not only that FDI enlarged the domestic supply of business services and forced local service providers to enhance their own performance through increased competition, but also contributed to improving skills, spreading know-how, enabling global connections and increasing the quality of services (Ghibutiu, 2002).

2.2 The changing patterns of Romania's trade in services

The prospects of EU accession and the consequent adoption of the *acquis communautaire* as well as Romania's gradual integration into the European market have increased pressures to upgrade the supply of services to the level of the old and NMSs respectively.

The picture which arises from the current BoP data on Romania's trade in services is, however, that of a still low degree of involvement of the domestic service industries in international trade flows. But the same figures reveal a rapid catching-up process of Romania in terms of upgrading its patterns of trade, due to fastly growing services exports especially in the last two years.

Table 1 illustrates the main characteristics of Romania's trade in services. The figures show that the country has very low export capabilities in services, which is sharply contrasting with its size and potential. In terms of value, Romanian services exports amounted to EUR 5,513 million in 2006, while imports reached EUR 5,507 million. In 2006, services exports accounted for a mere 0.2 per cent share in total world services exports. When compared to the NMSs, Romania's services exports are about three times smaller than Poland's, and about two times lower than Hungary's and the Czech Republic's (in 2005). Even though the share of services exports in the country's total exports of goods and services increased during the 1995-2006 period, being now closer to the world average, it is still low when compared to the European average.

However, quite interesting conclusions may be drawn when analyzing the evolution of Romania's trade in services in terms of dynamics. As seen in Appendix Table 2, the average annual growth rates of goods and services flows (in nominal terms) for the whole 1995-2006 period are not very much differentiated. The growth of services exports exceeded exports of goods (16% and 14% respectively), while services imports lagged behind the growth in goods (14% and 16%). During 1995-2000, both exports and imports of services grew slower than those of goods, but in 2000-2006 services exports outperformed goods exports by 5 percentage points (20% and 15%). In fact, services exports took a substantial speed in the last two years, when their average annual growth

rate more than doubled compared to goods (37% and 16%). Services imports grew also faster than the imports of goods (33% and 24%).

Table 1: Romania's trade in goods and services, in 1995-2007

	1995 ¹	2000 ¹	2001 ¹	2002	2003	2004	2005	2006	Jan.-May 2007 ²
Goods (EUR mln)									
Export FOB	6117	11269	12712	14676	15614	18935	22255	25850	11716
Import FOB	7336	13099	16028	17437	19569	24258	30061	37609	7852
Balance	-1219	-1830	-3316	-2761	-3955	-5323	-7806	-11759	-6136
Services (EUR mln)									
Credit	1155	1899	2270	2482	2671	2903	4104	5513	3048
Debit	1407	2167	2398	2473	2609	3116	4448	5507	2731
Net	-252	-268	-128	9	62	-213	-344	6	317
Services share in total trade (%)									
Export	16	14	15	15	15	13	16	18	21
Import	16	14	13	12	12	11	13	13	13

Notes: ¹ Data for 1995, 2000 and 2001, expressed in USD in the BoP statistics, have been transformed in EUR (ECU for 1995) at the following average annual exchange rates: 1 ECU=1.2932 USD in 1995; 1 EUR=0.9199 USD in 2000; 1 EUR=0.8956 USD in 2001; ² Provisional data.

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

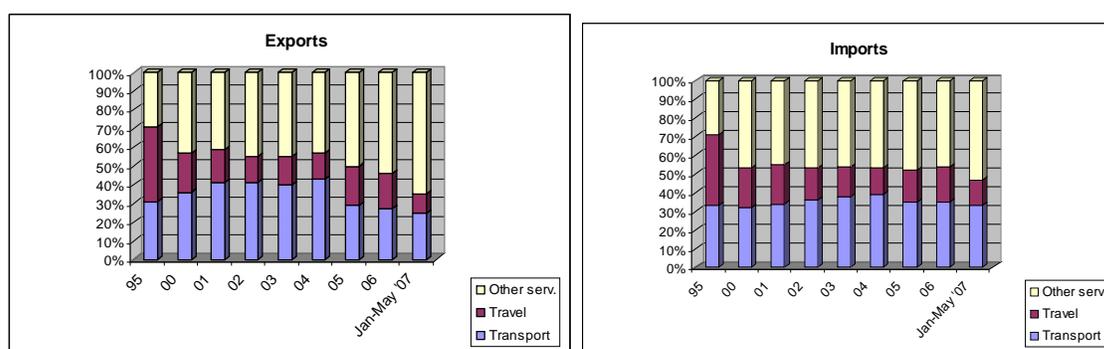
The balance of trade in services has also witnessed positive changes. The growing deficits recorded in the 1995-2005 period (with the exception of 2002 and 2003) contributed largely to the structural deterioration of Romania's balance of payments, in contrast to all the other NMSs. However, the year 2006 seems to be a turning point in this respect, as the modest EUR 6 million surplus for the entire year has been followed by an impressive one in the first 5 months of 2007 only (EUR 317million). This is a remarkable change in the context of growing concerns regarding the already huge trade deficit in goods.

When looking at the structure of Romania's trade in services by its main components (Figure 1), one can notice the radical changes that are under way. In 1995, Romania's trade in services still reflected the inheritance of the past economic regime. Accordingly, it was characterized by the predominance of traditional service components – such as transport and related services, as well as travel – and the scarce share of business services subsumed under the “Other services” component. By contrast, during the 2000-2006 period, the share of “Other services” increased from 43% in exports and 47% in imports in 2000, to 54% and 46% respectively in 2006. Moreover, the figures for the first 5 months of 2007 show a dramatic rise in the respective shares, i.e. up to 65% for exports, and 53% for imports.

Thus, the “Other services” exports share was higher than the world average already in 2005, reflecting an important qualitative change in the structure of Romania's trade in services. A worrying trend may be observed for the “Travel” component, which has a very low share in total services trade both compared with the country's potential in tourism and with the world average (28% in 2005).

The three components have contributed differently to the services trade balance during 1995-2006 (Appendix Table 3). “Travel” has recorded chronic deficits, while “Transport” turned from a deficit in 1995 into increasing surpluses in 2000-2004, but went back to significant and growing deficits in 2005 and 2006. The “Other services” component has contributed to the large services trade deficits during 1995 and 2000-2005 (with the exception of an insignificant surplus in 2003), but a trend reversal can be observed at present. The EUR 431 million surplus recorded in 2006 compensated the deficits of the two other components. This was possible due to the very high dynamics of the services exports within this component, i.e. 45% annual growth rate in 2006. It is noteworthy that the surplus of the “Other services” component went up to EUR 538 million in the first 5 months of 2007 only, due to an 57% increase over the same period of 2006.

Figure 1: The structure of Romania’s trade in services by main components, in 1995-2007
(shares in total services trade - %)



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

2.3 Romania’s trade in offshorable services

It is important for our analysis to dig deeper into the evolution and structure of the “Other services” component of Romania’s trade in services, as it includes the offshorable service categories. Specifically, we aim to address the following questions: Is there a rise in services offshoring in Romania in recent years as featured by the BoP data on trade in services? Do the data support the view that Romania is increasingly arising as a recipient of offshored services? For this purpose, we will analyse Romania’s trade in offshorable services, i.e. “computer and information services” (CIS) and “other business services” (OBS), as defined in Section 1.

In value terms, exports and imports of CIS were in the order of EUR 374 million and EUR 333 million respectively in 2006. The OBS exports and imports amounted to 1,316 million and EUR 1,042 million respectively. The recorded flows are very small if compared with the old EU member states and even with some of the NMSs, but the export dynamics are impressive, as the cumulative value of the two categories was more than 24 times larger in 2006 than in 1995 (Table 2). Further, the average annual growth rate of offshorable services exports during the 2000-2006 period was much higher than for total services exports or goods exports (34% compared to 16% and 14% respectively) (Appendix Table 2). Moreover, their growth speeded up during the last two years (64%

compared with 34% and 16% respectively in the 2004-2006 period. This explains why the share of the two services categories in the country's total services exports reached 31% in 2006 (up from 6% in 1995 and 20% in 2000) and 33% in the first five months of 2007. Already in 2003, their shares were comparable with those of the two service categories in world services exports (i.e. 4% both for Romania and the global level in the case of CIS, and 22% and 24% respectively for OBS).

Table 2: Romania's trade in offshorable services, 1995-2007

	1995 ¹	2000 ¹	2001 ¹	2002	2003	2004	2005	2006	Jan. - May 2007 ²
Computer and information services (CIS) – EUR million									
Credit	2	48	56	82	95	114	268	374	87
Debit	2	32	38	29	39	65	283	333	152
Net	0	16	18	53	56	49	-15	41	35
Share in services (%)									
Credit	0.2	2	2	3	4	4	6	7	6
Debit	0.1	1	2	1	1	2	6	6	6
Annual growth (%)									
Credit		109	17	46	16	20	135	40	6
Debit		33	20	-24	34	67	335	18	6
Other business services (OBS) – EUR million									
Credit	67	326	402	542	593	517	855	1316	817
Debit	248	543	568	680	665	757	851	1042	406
Net	-181	-217	-166	-138	-72	-240	4	274	411
Share in services (%)									
Credit	6	17	18	22	22	18	21	24	27
Debit	18	25	24	27	25	24	19	19	15
Annual growth (%)									
Credit		24	23	35	9	-13	65	54	48
Debit		35	5	20	-2	14	12	22	6
Total offshorable services (CIS+OBS) – EUR million									
Credit	69	374	458	624	688	631	1123	1690	1004
Debit	250	575	606	709	704	822	1134	1375	558
Net	-181	-201	-148	-85	-16	-191	-11	315	446
Share in services (%)									
Credit	6	20	20	25	26	22	27	31	33
Debit	18	26	25	29	27	26	25	25	20
Annual growth (%)									
Credit		31	22	36	10	-8	78	50	39
Debit		35	5	17	-1	16	38	21	7

Notes: ¹ Data for 1995, 2000 and 2001, expressed in USD in the BoP statistics, have been transformed in EUR (ECU for 1995) at the following average annual exchange rates: 1 ECU=1.2932 USD in 1995; 1 EUR=0.9199 USD in 2000; 1 EUR=0.8956 USD in 2001; ² Provisional data.

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

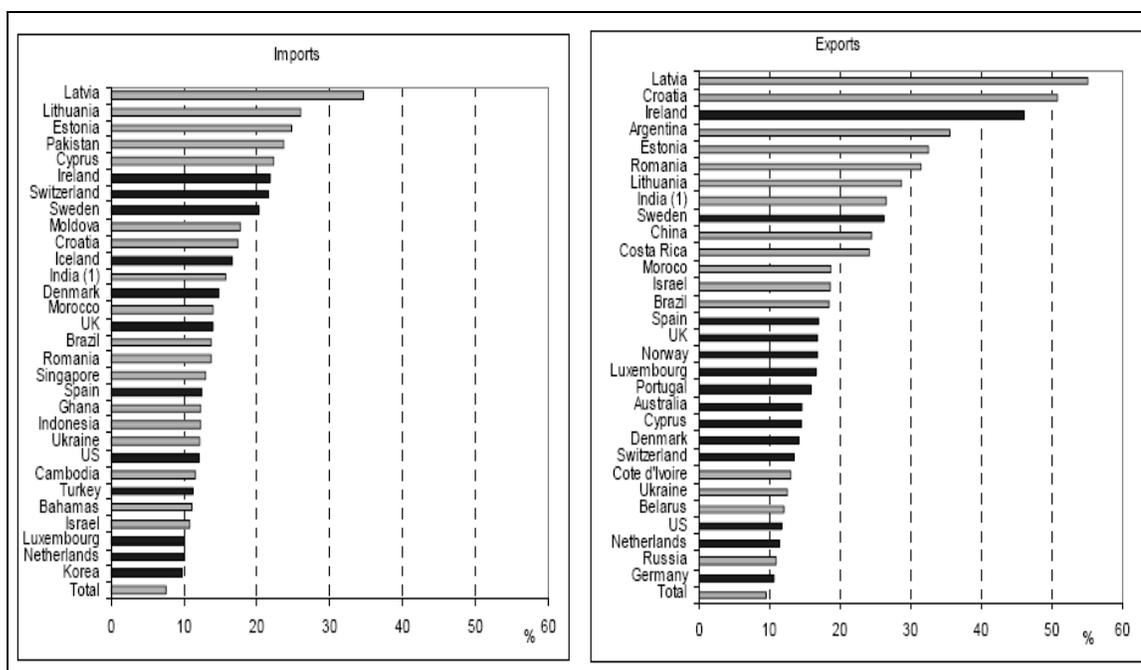
When looking at the annual growth rates, 2005 is definitely the booming year for the offshorable services exports (78%). Export value increased by 65% in the case of OBS and even more in the case of CIS (135%), but from a much lower level. OBS imports rose by 38% and CIS imports by 335% (the latter might be explained in part by increased FDI generating increased imports). Nevertheless, at the aggregated level, the growing gap between the rise in exports and imports since 2005 triggered a remarkable positive shift

in Romania's trade in services. If these two categories fueled the large services trade deficits until 2005, the EUR 315 million surplus in 2006 counterbalanced the deficits in the transport and travel components, and significantly contributed to the first major surplus in Romania's trade in the "Other services" component after 1990.

A brief international comparison by van Welsum and Reif (2006) confirms Romania's ranking among the countries with the highest growth of exports and imports of CIS and OBS during the last decade.

Figure 2 illustrates the average annual growth rates of exports and imports of CIS and OBS over the period 1995-2004 for the top thirty countries. It shows that Romania has experienced rapid growth of these exports and imports like many of the countries often mentioned as low-cost locations for offshored services (such as India, China, Brazil as well as other East European countries), which may confirm their emergence as offshoring locations in recent years. However, some of these countries, including Romania, are growing from a very low level, and some of the rapid growth is explained by their economic development (van Welsum and Reif, 2006)

Figure 2. The top 30 countries with rapid average annual growth of exports and imports of computer and information services and other business services, in 1995-2004 (CAGR)



Source: van Welsum and Reif (2006, p.6).

In terms of average annual growth rates of the value (in USD terms) of exports of CIS and OBS during 1995-2004, Romania ranked 6th worldwide with over 30%, being exceeded only by Latvia (almost 55%), Croatia (over 50%) and Ireland (over 45%), followed at a larger distance by Argentina (almost 35%) and Estonia (slightly more than Romania). In terms of average annual growth rates of the value of imports of CIS and OBS during 1995-2004, Romania ranked only 17th with over 10 per cent, while Latvia (35 per cent) topped the list, followed at a large distance by Lithuania, Estonia, Pakistan and Cyprus (each with over 20 per cent).

To see how Romania performed more recently in comparison with the three Baltic countries that are in the top 7 exporters in Figure 2, we have calculated – on the basis of Eurostat data, in Euro terms – the annual growth rate of the 3 countries in 2006. While Romania's offshorable services exports growth rate was 50%, Estonia's was 20%, Latvia's 15% and Lithuania's only 2%.

Table 3: Offshorable services export performance in selected NMSs and the EU-15, 1995-2006
(Value in EUR million and % shares)

Year		EU-15	CZ	PL	HU	SK	RO	BG
Value								
	Services, of which	400510	5138	8161	3977	1817	1142	1354
1995	Offshorable, of which:	88904	1368	975	...	...	69	...
	CIS	6154	4	9	...	...	2	...
	OBS	82750	1364	966	...	488	67	...
	Services, of which	677714	7403	11304	6604	2487	1902	2355
2000	Offshorable, of which:	187084	1583	1463	1498	560	375	70
	CIS	24209	103	66	131	56	48	6
	OBS	162875	1480	1397	1367	504	327	64
	Services, of which	890666	8663	13077	10313	3542	4104	3483
2005	Offshorable, of which:	279538	1528	2298	2939	714	1123	225
	CIS	46683	148	159	311	94	268	26
	OBS	232855	1380	2139	2628	620	855	199
	Services, of which	...	9373	16324	10677	4306	5513	3991
2006	Offshorable, of which:	...	1785	3356	3138	859	1690	451
	CIS	...	303	328	374	134	374	41
	OBS	...	1482	3028	2764	725	1316	410
Shares in services								
	Offshorable	22	27	12	...	...	6	...
1995	CIS	1.5	0.1	0.1	...	...	0.2	...
	OBS	21	26	12	...	27	6	...
	Offshorable	28	21	13	23	22	20	3
2000	CIS	4	1	0.6	2	2	2	0.3
	OBS	24	20	12	21	20	17	3
	Offshorable	31	18	18	28	20	27	6
2005	CIS	5	2	1	3	3	7	1
	OBS	26	16	16	25	17	21	6
	Offshorable	...	19	20	29	20	31	11
2006	CIS	...	3	2	3	3	7	1
	OBS	...	16	18	26	17	24	10

Note: CZ=The Czech Republic, PL=Poland, Hu=Hungary, SK=Slovakia, BG=Bulgaria, RO=Romania
Source: Data extracted from Eurostat Newcronos (2007).

Based on the same Eurostat data, we made a broader comparative analysis on the export performance of offshorable services in Romania and other five NMSs (the Czech Republic, Poland, Hungary, Slovakia, Bulgaria) as well as the EU-5 for the 1995-2006 period. From Table 3 we can see that in value terms, Romania is still lagging behind Poland, Hungary and the Czech Republic, but is catching up due to much higher growth rates than the three countries during the analysed period. In terms of the shares of the two categories in total services exports, Romania had already in 2000 a situation comparable

with the Czech Republic, Hungary and Slovakia and much better than Bulgaria and Poland, but was still behind the EU-15, while in 2005 Romania's CIS share was the highest among the selected NMSs and surpassed that of the EU-15.

To get a better picture of Romania's position among its competitors in attracting offshored services, we have calculated the competitiveness of selected NMSs in offshorable services in relation to the EU-15 for the 1995-2005 period and to the six NMSs as a group of countries for 2006, based on indices of revealed comparative advantage, which are useful in identifying the comparative advantage/disadvantage. We used the original RCA index formulated by Balassa (1965) calculating the shares of the offshorable service categories in total services [$B = (X_{ij}/X_{it})/(X_{nj}/X_{nt})$, where: X = exports; i = a country; j = a commodity; t = a set of commodities and n = a set of countries].

The figures in Table 4 demonstrate a revealed comparative advantage of Romania in relation to the EU-15 countries in the case of CIS in 2005, and a comparative advantage in both types of offshorable services related to all the selected NMSs in 2006.

Table 4: RCA in offshorable services for selected NMSs, 1995 – 2006

Year	Service category	CZ	PL	HU	SK	RO	BG
1995	Offshorable, of which:	1.198	0.536	...	...	0.275	...
	CIS	0.050	0.073	...	...	0.087	...
	OBS	1.285	0.573	...	1.299	0.282	...
2000	Offshorable, of which:	0.775	0.467	0.822	0.815	0.714	0.109
	CIS	0.391	0.164	0.559	0.633	0.705	0.065
	OBS	0.832	0.514	0.861	0.844	0.715	0.113
2005	Offshorable, of which:	0.560	0.560	0.908	0.643	0.873	0.207
	CIS	0.327	0.232	0.575	0.505	1.246	0.143
	OBS	0.609	0.626	0.974	0.669	0.797	0.218
2006	Offshorable, of which:	0.844	0.911	1.307	0.884	1.360	0.502
	CIS	1.032	0.645	1.129	1	2.193	0.323
	OBS	0.814	0.954	1.335	0.866	1.232	0.531

Notes: RCA is calculated in relation to EU-15 for 1995, 2000 and 2005, and to the group of the six NMSs for 2006.
Source: Authors' calculations based on data extracted from Eurostat Newcronos

Up to now we may conclude that Romania reveals a comparative advantage in offshorable services, especially in the CIS category for the last two years, when exports of offshorable services have experienced a very fast growth.

2.4 Offshored *versus* offshorable services

What we cannot however find out from the analysis of the BoP data is how much of Romania's offshorable services exports has been really generated by the offshoring phenomenon. To try to get an answer to this question, we will look into the Eurostat enterprise-level statistics.

Fortunately, Romania is one of the 14 EU member countries (along with Denmark, Germany, Greece, Spain, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia, Finland, Sweden, UK) that are part of a development project aimed at gathering more detailed information on the business services sector. The data – resulting from a voluntary survey

carried out in 2005 (reference year 2004) and analysed by Eurostat (2007a) – show that in the case of Romania 52% of the exporting companies declared “outsourcing driven demand” (i.e. exports led by international outsourcing) as a reason for their exports and 10% declared their affiliation to a TNC as a reason for exporting (i.e. exports led by captive offshoring). In the case of international outsourcing, only Poland (88%) and Greece (56%) had higher shares of exporting companies. The percentage of companies being affiliates of TNCs was the highest in Latvia (29%). All the other NMSs (except Slovenia) had higher shares of companies exporting due to their affiliation to a TNC than Romania (Slovakia -19%, Poland -18%, Lithuania -15%). If taking into account only the medium and large exporting enterprises from Romania, 44% motivated their exports by international outsourcing and 29% by captive offshoring. The enterprise-level statistics provided by the National Institute of Statistics from Romania (NIS, 2006) show for the same year that the top 20 companies ranked by turnover in each of the fields of activity considered business services (NACE codes 72, 741, 742, 743, 744 and 745) were generating between 26.6% and 36.15% of the total turnover of the respective business activity.

When linking the Eurostat data with the NIS, we come to the conclusion that already in 2004 an important part of Romania’s business services exports were associated with the offshoring process. Without any doubt service offshoring to Romania has generated even more exports since 2005, at least under the impact of captive offshoring as it will result from the FDI analysis in the next section.

3. FDI and the Offshoring Phenomenon in Romania

Increased FDI flows to the NMSs have played a major role in upgrading their economies, in reversing the long-lasting bias against services and in enhancing their structural convergence with the old member states’ in terms of services development.

In the largest FDI host countries – the Czech Republic, Hungary, Poland – the industrial composition of inward FDI has been gradually shifting from manufacturing towards services, and within services, from network services privatized in earlier years towards business services. In these countries, services had already become dominant in FDI in the late 1990s. In Romania the structural change has been slower with manufacturing retaining a much higher share of FDI.

3.1 Recent trends in FDI

Several explanations may be put forward for Romania’s delay in comparison with the other NMSs in attracting FDI, especially in services. They are related to the specific circumstances of the systemic transformation, i.e. the more severe inheritance of the past regime, the slow speed of the economic and institutional reform until the middle of the 1990s, and particularly the slow progress in privatisation. The latter has to be seen as one of the major factors responsible for the small amount of FDI flows attracted by Romania hitherto.

Nevertheless, more recent FDI data prove the increasing attractiveness of Romania as a target for FDI inflows. Developments in the volume of inward FDI flows in the last three years reflect an unprecedented intensification of foreign investor’s activity which is

sharply contrasting with the trends prevailing in the earlier years (Table 5). The average annual amount of FDI flows oriented towards Romania increased over 4 times during 2004-2006 compared with the 2001-2003 period. After the turning point in 2004, FDI inflows continued to rise and reached their highest level ever in 2006, with a total amount of EUR 9,082 million, according to national BoP data. The existing FDI stock was estimated at EUR 31 billion by the end of 2006 (estimation done by the Romanian Agency for Foreign Investment - ARIS). The remarkable growth rates of inward FDI flows in the recent years are suggesting a notable increase of Romania's attractiveness for TNCs locational decisions.

Table 5: FDI indicators for Romania and selected NMSs, in 2000-2006

Country	FDI inflows (EUR million)							2005 ¹	
	2000	2001	2002	2003	2004	2005 ¹	2006 ¹	FDI stock (EUR million)	FDI stock/inhabitant (EUR)
CZ	5404	6296	9012	1863	4007	8837	4752	50404	4926
HU	2998	4391	3185	1888	3633	5559	4874	51815	5142
PL	10334	6372	4371	4067	10279	6566	11093	70000	1835
SK	2089	1768	4397	593	1016	1694	3324	13333	2475
BG	1103	903	980	1851	2727	2326	4105	9674	1253
RO	1147	1294	1212	1946	5183	5213	9082	21885	1012

Note: ¹ Revised data for Romania and preliminary data for the rest of the countries.

Sources: National BoP Statistics for Romania; WIIW (2006) for the 2000-2005 figures for other NMSs; ARIS (2006) for 2006 data for the rest of the countries.

In terms of the main FDI indicators (share of inward stock in GDP, FDI stock per inhabitant) Romania continues to rank behind the three top performers among the NMSs. Nevertheless, the high dynamics of FDI inflows during 2004-2006 period suggest a sustained catching-up process, and it may be assumed that in part the increased FDI amounts are attributable to intense offshoring activities unfolding between Romania and companies from the EU and the rest of the world.

While the above figures alone do not offer any point about the current level of services offshoring, the latest changes in the industrial composition of Romania's inward FDI stock may support our assumption that services offshoring gained momentum in recent years. According to data from the National Trade Register, manufacturing still accounted for 51% of Romania's FDI stock by the end of 2006. However, the available data (even though at a highly aggregated level) suggest an expansion of TNCs in services, and particularly in business-related services (including financial services, insurance and other business services). The share of this latter highly aggregated services category increased to 26% by the end of 2006, followed by wholesale trade (6.7%), retail trade (6.3%), transport (6.4%), construction (1.6%) and tourism (1.5%). The National Trade Register data refer only to the statutory capital (i.e. paid-in at incorporation + increases – decreases). Nevertheless, the rise in business-related services' share both in the number of companies and in the statutory capital stock demonstrates an intensification of FDI in this category in the last years, as seen in Table 6.

When analysing the evolution of this aggregated services category, we have to keep in mind that at present Romania is characterized by substantial FDI penetration in infrastructure services (e.g. banking, telecommunications, water, electricity), that are a precondition for attracting service offshoring, but do not represent the offshorable services that we are tracking. For example, in 2006 the most important investment included in this broad category was the Erste Bank's EUR 2.2 billion in taking over 36.8% of the Romanian Commercial Bank's stock.

Table 6: FDI in business-related services in Romania, 2001-2007¹

	2001	2002	2003	2004	2005	2006	June 2007
Total FIEs ² (thou), of which:	82.4	90.6	97.2	107.4	119.1	131.9	139.9
Business-related services (%)	8.6	11.3	12.9	15.3	16.7	24.5	26.1
Stock of statutory capital (EUR billion), of which:	7.5	7.2	7.7	10.2	12.9	15.3	16.5
Business-related services (%)	17.0	16.7	15.8	16.7	21.7	26.8	26.5

Note: ¹ All figures are for the end of the period; ² FIEs = foreign investment enterprises.

Source: National Trade Register, Companies by FDI, Statistical Synthesis.

3.2 Offshored services through FDI

In business services and R&D, FDI played a relatively limited role in Romania until recently. According to a quantitative assessment of total FDI projects in 2002-2003, monitored in five key services areas (i.e. financial services; telecommunications; headquarters and distribution centres; R&D and shared services/call centres), Hungary led as location among NMSs in terms of number of FDI projects (121 projects and a share of 14% in the total number of projects), followed by Poland (116 projects and respectively 14%) and the Czech Republic (95 projects and respectively 11%). Romania accounted for only 77 projects (a share of 9%), followed by Bulgaria (53 projects and respectively 6%) and Slovakia (43 projects and respectively 5%) (UNCTAD, 2004)

Until the last two years, Romania did not rank among the attractive offshoring locations worldwide. Its involvement in export-oriented FDI projects related to offshored services was rather insignificant. The potential for services offshoring may partly be gauged through the examination of the number and destination of TNC projects worldwide in export-oriented services undertaken by UNCTAD (2004) (see Table 7). This can be considered as a proxy for offshoring trends in some services. The main categories of such projects reviewed in the 2002-2003 period include: (1) shared services centres (back-office services); (2) call/contact centre services (front-office services); (3) IT services; and (4) regional headquarter services. All these services can be fragmented and made into parts of integrated international production systems (even though their locational determinants as well as their potential differ).

The figures show that out of the total number of global FDI projects related to services offshoring in 2002-2003 CEECs accounted for 31 for call centres, 19 for shared services centres, 24 for IT services and 17 for regional headquarters. The shares in the four categories of offshored service represented 6%, 14%, 4% and 3% respectively. In

absolute terms, the Asian countries are far ahead of the CEECs in all project categories. However, when relative GDP adjustments are done (i.e. the number of projects is adjusted by the relative share of each geographical area in the world economy), the CEECs reveal relatively strong weight in call centres and shared service centres, in the latter case CEECs' share even surpassing that of South and East Asia (Stare and Rubalcaba, 2005).

Table 7: Export-oriented FDI projects related to services offshoring, by destination and main services categories, 2002-2003

Country	Call/contact centre services ¹		Shared services centres ²		IT services ³		Regional headquarters ⁴	
	No. of projects	% of total	No. of projects	% of total	No. of projects	% of total	No. of projects	% of total
World total, of which:	513	100	139	100	632	100	565	100
CEE ⁵ , of which:	31	6	19	14	24	4	17	3
Bulgaria	1	-	-	-	-	-	1	-
Czech Republic	9	2	6	4	5	1	-	-
Hungary	11	2	7	5	4	1	4	1
Poland	3	1	5	4	4	1	3	1
Romania	1	-	-	-	2	-	4	1
Slovakia	4	1	-	-	-	-	-	-

Notes: ¹ *Call/contact centre services* (front-office services), including help desk, technical support/advice, after-sales, employee enquiries, claims enquiries, customer support/advice, market research, answering services, information services, customer relationship management; ² *Shared services centres* (back-office services), including claims/accounts/transaction processing, query management processing, customer administration processing, HR/payroll processing, data/logistics processing, quality assurance; ³ *IT services* including software development, application testing, content development, engineering and design, product optimization; ⁴ *Regional headquarters* (headquarters, coordination centres); ⁵ Central and Eastern Europe includes all former communist countries in the region.

Source: UNCTAD (2004, p.162-163).

What do the data show in the case of Romania?

First, with a total number of only 7 projects attracted in 2002-2003, Romania proved to be less attractive as location for offshored services than Hungary, the Czech Republic and Poland. At the same time, its performance was superior to that of Slovakia and Bulgaria.

Second, Romania benefited of only one call/contact centre project and no project related to shared services centres, while Hungary received 7 shared services centres, the Czech Republic 6 and Poland 5.

Third, Romania and Hungary were leading destinations in CEE for projects related to regional headquarters, each accounting for 4 such projects. It is noteworthy that, while these services are also export-oriented in nature, they differ from those of the other three categories of FDI projects, as they are not driven primarily by labour cost differentials. Regional headquarters provide high-level services employing senior management and professionals. To attract such projects, locations need to offer a good quality of life, convenient air connections and access to competent suppliers of business support services. Key location determinants include proximity to customers (both external and networks of foreign affiliates located in the region), market growth opportunities, access to a skilled workforce, a supportive business and regulatory climate as well as a high-quality physical and ICT infrastructure. While many developing and transition countries

increasingly seek to attract services provided in headquarters, only few of them meet all of these requirements and prove to be successful (the United Arab Emirates, Hong Kong, China and Singapore). This is an important observation when taking into account the dynamic spread of this kind of projects in Romania since 2005.

From the above it may be concluded that during 2002-2003 TNC projects related to services offshoring in the CEE region have been concentrated mainly in two countries – Hungary and the Czech Republic – while the number of the projects oriented towards Romania has been rather scarce. However this situation has changed in the last two years and the perspective looks favourable when taking into account FDI-related trends in Romania. Due to continued steady economic growth, FDI inflows are expected to expand, especially from traditional investors seeking to reap the benefits from Romania’s redefined location advantages following its EU accession. Besides, privatisation is likely to pick up again, as the country will seek to further reduce the public sector debt in line with EU requirements, which also augurs well for FDI and offshoring services to Romania. Prospects for inward FDI will also depend on the success of Romania in positioning itself as a production and services platform for TNCs originating both from Europe and other regions.

Table 8: Services offshoring investment projects monitored by ARIS, in 2006

No.	Company	Location	Industrial sector	Investment value EUR Million	No. of jobs	Start of the project with ARIS	Investment implementation period
1	GENERAL ELECTRIC (USA)	Bucharest	Services	80	170	2005	2006
2	HEWLET PACKARD (USA)	Bucharest	Services	50	1200	2005	2006
3	INFINEON (Germany)	Bucharest	R&D microelectronics	3.1	200	2005	2006
4	MICROSOFT EMEA (USA)	Bucharest	Technical support center	13.1	750	2005	2006
5	WIPRO (India)	Bucharest	Call center	5	400	2005	2006
	TOTAL			151.2	2720		

Source: ARIS, Monitored Projects 2004-2006.

The surge of FDI inflows in recent years indicates an accelerated pace of offshoring to Romania. The question arises: What are the trends in the more recent years, when Romania’s offshorable services exports increased significantly? The answer comes from additional sources.

The Romanian Agency for Foreign Investment – ARIS (the governmental agency responsible for monitoring FDI and providing consulting to foreign investors) displayed on its website “the successful investment projects assisted and monitored” during the 2004 – 2006 period. Out of the 12 investment projects listed for 2004 (EUR 286 million in total investment value and 9380 total job number creation) and the 9 projects from 2005 (EUR 185 million investment, 2275 new jobs), none represented a service

offshoring project. In turn, out of the 24 investment projects that are listed for 2006 (with cumulated investment value of EUR 469.7 million and generating in total 6060 new jobs), 5 projects are definitely belonging to the services offshoring category (Table 8). They represent 21% of the number of successful projects monitored by ARIS in 2006 and their share in the total investment value is 32% and in total number of new jobs 45%. This demonstrates the increasing importance of offshoring projects in terms of their impact on capital investment and employment creation in Romania. Box 1 provides a short description of the projects included in Table 8.

Box 1

Genpact, a General Electric division providing business services, began its operations in Romania in September 2005. Genpact Romania is the first shared services center opened in the country, employing 700 persons in June 2006. Their number is estimated to increase to 2,000 until the end of 2008. The center in Bucharest is declared by the parent company as their fastest-growing location in Europe (the other centers being in Hungary, Spain and Netherlands), due to its “well-educated multilingual talent pool”. In March 2006, the American corporation **Hewlett Packard** inaugurated its new BPO centre in Bucharest. The development of the new services centre involves FDI worth of about USD200 million during the next 5 years and the creation of about 1,200 new jobs until 2008. The centre provides BPO services to the partners and clients of the corporation in Europe, the Middle East and Africa. For the beginning, it offered jobs for 325 Romanian specialists, but the corporation intends to increase their number to 800 by the end of 2006.

Microsoft opened its affiliate in Romania in 1996, with only five employees, representing practically a market-seeking (horizontal) FDI. But in May 2007, it opened in Bucharest its Global Technical Support Center EMEA to serve as regional center for Europe, the Middle East and Africa. The number of employees is expected to increase to 200 until the end of 2007 (by recruiting IT specialists from Romania as well as from Eastern Europe), and to 750 in the coming years.

Wipro proves that even big outsourcing vendors from India have become interested in offshoring their services to Romania (at least of the call center type) in order to better serve their customers from Eastern Europe.

Infineon, a German microelectronic producer, is an example which illustrates that also companies from other industries than services are offshoring to Romania their R&D services function due to the highly-qualified engineering professionals of the country.

Even snapshots on media information during the last two years – which remain basically the main source for monitoring the real trends in offshoring activities in Romania, similarly to other countries – show that there are many other important investment projects that have not been monitored by ARIS and that many global services providers are already present in the Romanian market. Perhaps most relevant are those media reports according to which during six months in 2006-2007 only, three major global players set up almost simultaneously their business processing operations (BPO) centres in Bucharest, i.e. Hewlett-Packard, Oracle and Microsoft. Most of these TNCs started with market-seeking investments (in the 1990s) and expanded later in efficiency-seeking investments, by offshoring to Romania some of their services functions, including export-oriented projects. In July 2007, The Business Week published a review of the companies from its TOP 100 Infotech that are already present in Romania. According to the report, the largest IT&C companies in the world have transformed Romanian people from customers into high quality labour force inputs in their production and R&D activities. Many software and business services suppliers from the TOP 100 Infotech companies are already well-known foreign investors in Romania. The examples include: Microsoft (9th position in the top), Accenture (16th), IBM (21st), Oracle (22nd),

Wipro (49th), Adobe Systems (98th). But important hardware and telecommunication equipment producers, such as Siemens (34th in the top), Hewlett-Packard (35th) and LM Ericsson (55th) have also offshored several internal services functions to Romania. However, not only the number of global BPO players present or entering the Romanian market is relevant for the dynamics of offshoring, but also their impact in terms of employment, as seen in Box 2. It is noteworthy that companies providing BPO services are among the most active employers in the Romanian economy, and the pace of their recruitments on the local labour market is faster than in any other traditional industry.

Box 2

Oracle, another prominent American company, started as a representative office in Romania in 1995. In May 2006, it launched its Oracle Tower building in Bucharest, where more than 10 competence centres are located, including the Oracle Partner Network Centre. The latter was inaugurated at the beginning of 2007 and is serving customers from 26 countries in 16 languages. All these centres had about 500 employees in May 2006. It was foreseen to increase their number to 1,000 until May 2007 and 1,500 by the end of 2008.

Adobe Systems set up its representative office in Bucharest by the end of 2006 through acquisition of the Romanian company Interakt, to which it outsourced services in the previous years. Adobe Systems Romania is covering also Bulgaria and the Republic of Moldova. The Romanian employees are involved in Adobe new product development.

Siemens (Germany) is the biggest foreign investor employer in Romania, with almost 2,000 persons employed in its several companies established in the country. It has R&D centres for the automotive industry in Timisoara and Iasi and for software development in Cluj and Brasov. The TNC took over a Romanian company in Cluj and has plans for more acquisitions in Romania in the forthcoming period.

LM Ericsson (Sweden) opened a Global Services Centre in Bucharest operating as a call centre for customers in Romania and several other countries.

All these unofficial sources show without any doubt the steady expansion of the services offshoring phenomenon in Romania and its growing extent, particularly under its captive form. The sustained and constant economic growth, the young pool of talents and the low levels of corporate and income tax have been mentioned among the main reasons behind the decisions of these companies to choose Romania as location. Further, these impressive developments in terms of services offshoring dynamics in Romania point towards the agglomeration and demonstration effects induced by FDI in the host economy. The case of Romania illustrates clearly that success in attracting offshore services has a cumulative dynamic on its own, i.e. success in one set of activities can lead to success in another, once a reputation for providing efficient and reliable services has been developed.

4. The Potential of Romania as Location for Services Offshoring

Notwithstanding the severe statistical shortcomings and the limits of interpretation, the findings presented in the previous sections suggest that a change in the status quo is under way. In other words, Romania is emerging as an increasingly interesting location for companies' international organisation of production. This section looks behind the main factors making Romania an attractive location for offshored services in the global and European context, and attempts to reveal the country's strengths and weaknesses in

the light of increasing competition it has to face in the highly dynamic global market for services offshoring.

Locational determinants

The search for competitiveness is driving offshoring at the company level. As to the choice of the foreign location for offshoring, among the determining factors are labour costs, workforce skills (particularly relating to computers and language), trade costs, the quality of infrastructure and institutions, the tax and investment regime (WTO, 2005). Hence, what makes Romania an attractive target for offshoring?

There is little doubt that labour cost savings are a major factor driving the offshoring decisions by companies globally. Labour cost differentials across different locations worldwide, including at the European level, play a prominent role among the determinants of offshoring. As far as wages and related policies are concerned, there have been long-standing differences between the more developed higher wage countries and the less developed lower wage EU members. With the accession of ten new countries in May 2004, followed by Romania and Bulgaria in January 2007, the discrepancies have further widened.

The wide differences existing in terms of labour cost both between the old EU members and the NMSs, as well as across the latter, are illustrated by Table 9. In 2005, the hourly labour cost for the EU-25 average was 11.5 times higher than that for Romania when considering the services sector alone (and 11 times higher when considering all economic sectors respectively). Romania has the lowest level of labour cost among the NMSs, comparable only with that of Bulgaria

Table 9: Labour costs in services in the EU and selected NMSs^{1,2}
(in Euro)

	2000	2001	2002	2003	2004	2005
EU-25	19.16	19.66	20.28	20.10	20.50	20.53
EU-15	21.70	21.94	22.62	23.11	23.64	...
Bulgaria	1.12	1.20	1.24	1.31	1.39	1.52
Czech Republic	4.10	4.94	5.66	5.74	6.21	7.25
Estonia	2.90	3.33	3.86	4.23	4.38	4.73
Latvia	2.24	2.29	2.43	2.41	2.55	2.81
Lithuania	2.65 ²	2.82	2.98	3.22	3.29	3.68
Hungary	...	...	...	5.27	5.75 ³	6.30
Poland	4.72	5.57	5.55	4.94	4.94	5.76
Romania	1.42	1.57	1.72	1.67	1.80	2.37
Slovenia	10.07	10.84	10.82	11.83	11.25	11.64
Slovakia	3.12	3.44	3.79	4.05	4.44	5.04

Notes: ¹ Services (excluding public administration) (NACE: G to K); ² Hourly labour costs, annual data estimated on the basis of quadrennial labour cost survey, covering enterprises with 10 or more employees; ³ Break in series; ⁴ Provisional value.

Source: Eurostat (2007b)

Another major advantage of Romania in attracting offshored services activities relates to the availability of well-educated and highly skilled workforce. While in terms of education level there are no notable gaps between Romania and the EU-average, and

the NMSs respectively, striking differences can be observed in terms of availability of highly skilled workforce, especially in those domains which bear relevance for services offshoring. According to a recent assessment by Economist Intelligence Unit (2006), Romania is leading in Europa as regards the availability of certified IT specialists. With about 64,000 IT specialists, Romania overtakes the United States or Russia in terms of IT specialists per 1,000 inhabitants. Moreover, out of the total 30,000 engineers graduating annually from technical universities, 5,000 are skilled in ICT. According to Brainbench's 2006 Global Skills Report, which documents technical and work skill certification worldwide, Romania ranked 5 among the top 10 countries across the world in terms of overall certifications in 2006. While Romania is behind the US, India, Russia and Ukraine, it is ahead of the United Kingdom, Canada, Belarus Philippines and Bulgaria. It follows that except for the United Kingdom and Bulgaria, no other EU member ranked among the top 10, which shows Romania's substantial advantages both over the old EU members and the NMSs.

An additional advantage for Romania arises out of the combination of relatively low wages, low corporate taxes and the use of subsidies.

As far as the fiscal regime is concerned, a wave of tax reductions was made by the majority of NMSs before joining the EU. According to a KPMG's corporate tax rates survey cited by UNCTAD (2004), not one of the NMSs ranked, as of January 2004, in the top 11 in terms of corporate tax rates, while six were in the bottom eleven.¹⁸ Since 2005, Romania applies a flat rate of 16% for both corporate and income tax. At present, the country ranks second in Eastern Europe in terms of low level of corporate tax rate, being surpassed only by Serbia, with 14% (e.g. Estonia applies 26%, Lithuania 29%, Latvia 25%, Russia 24%, Ukraine 25%, and Slovakia 19%, while the Czech Republic intends to apply 16% until 2010). In terms of income tax, however, the Romanian 16% flat rate is over the level currently applied by other East European countries, such as Ukraina and Russia (13%), Serbia (14%) and the Czech Republic (15 %) (Stefan, 2007).

Evidently, a simple comparison of corporate tax rates is not sufficient for assessing the relative tax burdens imposed on comparison (as the profits to which the tax rates are applied, i.e. "the tax base" also needs to be taken into account). Nevertheless, the relatively low fiscality in Romania is adding to the attractiveness of the country both in the European and global context. At the EU level, services offshoring and international investment respectively are believed to be driven not as much by differences in corporate tax rates between member states, but mainly by other factors, such as unit labour costs or agglomeration economies (geographical location advantages, market size, external economies, human capital, the general business environment) (European Commission, 2006). Nevertheless, the low level of corporate tax has been an important factor behind the decisions of Hewlett-Packard, Oracle and Microsoft to choose Romania as location for their offshored services centres, at least according to their official statement.

Further, under the EU Structural Funds, Romania can expect (in the framework of the objectives defined by the EU regional policy) total transfers amounting to EUR 29.2 billion over the 2007-2013 period from the common budget of the EU, out of which EUR 17.2 billion represent Structural and Cohesion Funds (the rest of EUR 12 billion is related to the Common Agricultural Policy). These funds are intended mainly for such purposes as building basic infrastructure (including transportation), human resource development, competitiveness and enterprise development, rural development and improving

environment. While the EU Structural Funds are not specifically directed to FDI, they may have an indirect effect on it, through enhancing FDI attractiveness and improving the investment climate in Romania.

The above combination of factors – further supported by an improved business climate and free access to the rest of the EU market – makes Romania an attractive location for efficiency-seeking FDI, both from other EU countries and from non-EU members.

While cost reduction followed by availability of highly skilled workforce are leading factors in terms of locational determinants of services offshoring, an additional key consideration is the quality of the telecommunications and IT infrastructure. The availability and access to a cost-effective and reliable telecom and IT infrastructure are critical to attracting all types of IT and IT-enabled offshored services. Given the high weight of telecom costs in total costs in low-income locations in the case of call centres, for instance, and due to the specific quality requirements that apply to voice transmissions, access to fibre-optic links is crucial for a country that seeks to attract call centres or shared services centres. The dynamic developments unfolding in this field in Romania in the last couple of years (particularly in respect of fix and mobile telephony penetration, broadband access, Internet and IT) are important prerequisites for encouraging and supporting increased offshoring activities from the EU, as well as other parts of the world. But in terms of ICTs Romania still has to catch up not only with the old EU member states, but also with the new ones.¹⁹

Apart from the above mentioned factors, there are many other key considerations which bear upon the decision of TNCs to prefer Romania as location for offshored services, particularly from a European perspective. Geographical proximity to EU-15 markets, language skills and linguistic traditions, historical ties and cultural affinity – are unanimously stressed by analysts when discussing the advantages of the NMSs over other popular low-wage locations in Asia or other parts of the world in terms of offshoring decisions taken by European companies. Further reasons for EU-15 companies to prefer Romania to the detriment of other low-wage locations worldwide relate to easier coordination of offshoring procedures due the same time zone, harmonised standards and other regulations, easier alignment of prices in a single currency (Euro) (Stare and Rubalcaba, 2005). And last but not least, the agglomeration effect of already present FDI act as location advantages (Hunya and Sass, 2005).

EU membership and services offshoring

While cost-related as well as non-cost factors are lying behind Romania's intrinsic advantages and potential as a favourite target for services offshoring, there is no doubt that its growing attractiveness is associated with the process of EU enlargement. Romania's accession into the EU has triggered a process of gradual structural transformation of the country, which has laid down the foundations for institutional, political and macroeconomic stability while making possible the liberalisation of international trade and investment flows. The EU enlargement provided an outstanding opportunity, particularly to EU-15-based companies, to take advantage of better production cost conditions by internalizing the labour cost advantages offered by the

NMSs, including Romania (European Commission, 2006). Firms in EU-15 choose to fragment their production processes and offshore some parts to Romania, either by setting up affiliates (captive offshoring) or by sourcing inputs from local producers (international outsourcing). Ample availability of skilled labour, relative low labour costs, low transport costs due to geographical proximity, cultural and linguistic ties and full EU membership have contributed to making Romania particularly attractive.

Viewed strictly from the offshoring perspective, the implications of EU membership for Romania are manifold and contradictory. Full membership in the EU means that the country needed to adopt the full body of EU law, the *acquis communautaire*. Without any doubt, the implementation of EU law has contributed to improving significantly the business environment and the attractiveness of Romania. It ensured a stable and predictable political climate that made investment more secure. On the other hand, the application of EU law (e.g. concerning labour standards or environmental protection) will bring about an increase in the cost of doing business. As Romania catches up to its Western neighbours, its cost advantages are starting to erode. Hence, the benefits of EU accession are likely to reduce cost advantages leading companies to look even further East to Russia, Ukraine and the other former Soviet countries.

That these trends are already at work is confirmed by the most recent survey conducted by the US consultancy company A.T.Kearney (2007a), according to which Romania's competitiveness in the global services offshoring market has diminished, as reflected by the decline in its ranking within the Global Services Location Index (GSLI), from 24 in 2005 to 33 in 2007.²⁰ Despite increasing its overall score in both 2005 and 2007, in 2007 Romania slipped several ranks in absolute, as well as relative terms, due mainly to relatively higher costs and lower availability of people, and because the marginal increases in its environment score were offset by reductions in its financial score. A similar losing of ground experienced the Czech Republic and Hungary, which together with Poland continue to maintain their position as the established services providers in the Central and East European region (CEE). In turn, the winning CEE countries were Bulgaria (which managed to replace the Czech Republic as the only country from the region in the top 10 offshoring locations in the world), as well as Slovakia and Poland, thanks to limited wage inflation, accompanied by improvements in people and environment scores.

Some remarks should be made regarding Romania's current performance in terms of services offshoring as compared to the other NMSs's. Firstly, despite Romania's notably larger population base (except Poland), the country lags far behind the other NMSs in terms of overall competitiveness in the European and global offshoring market. Secondly, as most countries covered by the GSLI index, including the NMSs, have increased their performance in 2007 compared to 2005, it follows that growth alone is not sufficient to maintain competitiveness both regionally and globally. And nor are the relative cost advantages any more enough to keep pace with increased competition, especially as these are steadily eroding, and talent and policy environment are now considered to increasingly define the competitive landscape.

The challenges facing Romania

A closer look at A.T.Kearney's GSLI country ranking reveals that the main factors behind Romania's downward move in 2007 are the relatively higher costs and lower availability of people.²¹ It is interesting to note that while some time ago Romania's main disadvantage to other countries, particularly NMSs, has been related mainly to its economic stability, now the human resources which tend to become limited are creating concern. Evidently, to this adds the clear downward trend in Romania's attractiveness in terms of relative cost advantages, due mainly to accelerating wages and currency appreciation.

An additional indication that Romania has started to face difficulties in respect of availability of talent pool is provided by the above mentioned Brainbench (2006) assessment, according to which Romania experienced a drop of 18 per cent in terms of overall IT skills certifications between 2005 and 2006 (unlike Belarus, India and Ukraine, for instance, which increased by 49 per cent, 47 per cent and 14 per cent respectively), and hence plunged from rank 4 to rank 5 among the top 10 countries across the world.

The downward trend in the active population combined with the migration of labour – estimated to be in the range of over two million people working currently abroad, more or less officially – are among the main factors behind the emerging labour shortage and the increasing pressures on the local labour market. Hence, this relatively new trend in the Romanian labour market is fueling fears that as the Romanian economy expands dynamically, pressures on wages will continue to grow until the moment they will trigger the risk of diminishing the current competitive advantages of Romania arising from its low labour costs. That these fears are justified, is demonstrated by the recent figures released by Eurostat, which show clearly that Romania is at the forefront of labour cost increases among EU member states.²² This is why the representatives of the domestic business circles are urging the Romanian authorities to initiate measures in view of mitigating the present labour shortage, by making the local labour market more flexible, including by allowing the temporary import of cheap labour from low-wage developing countries. An additional problem arises from the fact that talent might emigrate or be enticed by competitors respectively, a danger that is already looming in the market for offshoring, as signaled by the big players in the services offshoring business present in the Romanian market.

In spite of all these newly emerging challenges facing Romania, the outlook for maintaining a favourable position as a services offshoring destination both in the European context and worldwide seems quite promising. At least two arguments may support this assertion.

On the one hand, there are signs that European companies are now considering more seriously services offshoring in the European context compared with earlier years. According to a recent survey carried out by McKinsey&Company (2006), demand for offshoring among Western European companies rose by half between 2004-2006 with Eastern Europe emerging as a favourite destination.²³ This means an important change compared with previous years, when European companies have been in general less prone to offshore services in comparison with their counterparts from the United States (except for the United Kingdom, which has followed the most closely behind the United States). Low wages comparable to India's, a relatively low risk profile for key factors

such as reliable infrastructure, as well as geographical and cultural proximity to Western Europe are cited among the primary advantages of Eastern Europe. It is also noteworthy, that the region is estimated to remain economically competitive for at least 15 years. This is in line with the A.T.Kearney (2007b) assessment, according to which even though wages started to rise, these countries will remain attractive as offshoring destinations in the foreseeable future.

On the other hand, there is a large untapped potential for services offshoring in Romania, which should not be overlooked. While the process focused so far on Bucharest, there are also many other cities in the country which are potential candidates for becoming offshoring centres. Mid-size cities such as Iasi, Cluj, Timisoara could turn into hubs for IT services and business process outsourcing, due particularly to their cultural environment (universities) and their large talent pools, but also owing to the fact that the labour cost advantages they may offer are more likely to remain attractive in the coming years, especially as in Bucharest the wages for experienced workers are rising fast. Turning these regional potentialities into reality will depend, however, on both the understanding by policy-makers of the importance of services offshoring for the Romanian economy and their capability to devise proper policies and mechanisms for harnessing the benefits this process may bring in the long run.

5. Concluding Remarks

We recognize that an accurate picture on services offshoring in Romania, as a host country, is practically impossible to obtain on the basis of available trade and FDI statistics, even if complemented through additional data from various private sources. Nevertheless, we found clear evidence for highly dynamic offshoring activities unfolding currently in the Romanian economy and for at least some of their effects on the country's trade in services. The remarkable annual growth rates recorded by exports in offshorable services in the last two years as well as the positive changes already visible in the patterns of services trade, in conjunction with the steady developments triggered by growing FDI presence in the Romanian economy may support our assertion.

Piecing together the scattered evidence, we arrived to the conclusion that in Romania the process of services offshoring has gained momentum compared to the early 2000s, under both its forms: captive offshoring and international outsourcing. Further, the available evidence highlights an accelerated pace of services offshoring in all main offshorable services categories, i.e. IT services, shared services centres (back-office services), call/contact centre services (front-office services), and regional headquarter services. This leads to the conclusion that Romania is arising as a strong candidate for all types of offshoring.

Several global players in the BPO market, including the top 10, are already present in the Romanian market and more are likely to follow. It is largely believed that the arrival of the big international players will bring about tighter competition, as well as diversified, higher quality services. The market for offshored services – and particularly BPO – is expected to grow significantly by 2008, according to professionals within the business, Romanian and foreign alike.

While Romania seems to be a preferred location for offshored services in the regional context, i.e. for EU-15-based companies, the evidence suggests that the process of offshoring is also largely driven by companies from other regions of the world owing to

the country's current and future potential as a host country. There is no doubt that the growing attractiveness of Romania is associated with its EU accession on January 1, 2007. The process of EU enlargement provided an outstanding opportunity to EU-15-based companies to take advantage of better production cost conditions by internalizing the labour cost advantages offered by Romania. Firms in EU-15 choose to fragment their production processes and offshore some parts to the country, either by setting up affiliates or by sourcing inputs from local producers. Ample availability of skilled labour, relative low labour costs, low transport costs due to geographical proximity, cultural and linguistic ties and full EU membership have contributed to making Romania particularly attractive.

The dynamic developments associated with services offshoring in Romania point towards the importance of agglomeration and demonstration effects induced by FDI in host countries. The case of Romania illustrates clearly that success in attracting offshore services has a cumulative dynamic on its own – success in one set of activities can lead to success in another, once a reputation for offering efficient and reliable services has been developed. Mutually reinforcing trends seem to create a dynamics that leads to further offshoring.

The opportunities for Romania to attract employment, trade and income-creating activities are significant, although at this stage, it is practically impossible to evaluate precisely *how* significant. The forces driving offshoring are powerful and the resulting economic benefits are a classic illustration of gains from trade and specialization. For Romania as a host country, the main benefits of services offshoring seem to include, so far: an increase of services exports and of economic activity through the operations of TNCs' subsidiaries, creation of additional jobs and higher wages, transfer of soft technology (under the form of knowledge and upgrading of skills), increased competition and higher quality services. On the downside, increased offshoring is possible to lead, particularly in the long run, to growing services imports and income transfers of TNCs to their home countries, bearing additionally upon the already huge current account deficits of the country. From a broader perspective, the benefits deriving from captive offshoring seem to outweigh the implied losses, at least for the moment. Two arguments arising from our paper may support this view: firstly, offshoring-related FDI generated more trade, particularly in new types of services and advanced services respectively; secondly, the steady increase in offshorable services exports has helped to reverse the earlier trend of the Romanian services balance to record chronic deficits.

While there are many reasons for the process of services offshoring to grow and spread in Romania, there are also several challenges to be faced. For benefits to be derived from offshoring, as part of the trend towards increasing globalisation of services activities, a robust domestic services sector is an essential precondition to be met. While the bias against services-led economic development faded away to a certain extent during the last decade, the Romanian authorities are still slow in grasping the crucial importance of services for the country's future development in general and the opportunities associated with services offshoring in particular. Therefore, it is highly time for the Government to become fully aware of the new opportunities opened up by the increasing globalisation of services and to play a more active role in ensuring the adequate technological, economic and institutional framework for cross-border services trade and FDI to expand. This is all so more important, as competition on the global offshoring

market is continuously growing, and just maintaining the current competitive capabilities is no longer sufficient to attract and retain the world's fast-growing offshored business services. As evidenced by the fastly changing country rankings within the recent attractiveness assessments, even successful exporters cannot stand still: they have to invest in new skills to move up the value chain as wages rise and cheaper competitors emerge.

Consequently, in order to mitigate the already visible risks of eroding its comparative advantage associated with the relatively low costs of labour in the mid and long term, Romania will need to continually upgrade its labour force through increased investments in education, particularly tertiary education, which is of utmost importance in view of creating the talent pool required by offshoring. Finding the right solutions for tackling skill shortage, which has become increasingly evident in recent years in the Romanian economy, is an urgent task. Measures are necessary to adjust the rigid labour market, including through introducing a new labour legislation and allowing for imports of cheaper labour from lower-income developing countries. Further progress in upgrading the information and telecommunications infrastructure is also a major prerequisite for keeping Romania's current comparative advantages, all the more as the country is lagging behind the other NMSs in terms of ICTs. Concurrently, proper governmental support is needed for securing a favourable business environment for the local services providers to grow and expand, especially as local services providers themselves will start to enter the global market for offshored services.

And last but not least, as services offshoring imply also an important regional dimension, it is of utmost importance to avoid the risk of offshoring to be concentrated in the capital city alone. Adequate initiatives by the Government at the regional level might encourage the spread of offshoring activities across different regions of the country, by developing several mid-size cities into hubs for IT services and business process outsourcing. Hence, to raise the business birth-rate, to forge strong partnerships between regional universities and business, develop the skills needed at the regional level and to improve the local infrastructure should be among the priorities of policy measures.

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 ICTs 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.

NOTES

¹ Several contributions have emphasized the need to approach offshoring as a “two-way street”. See, for instance: Amiti and Wei (2004); van Welsum and Reif (2005, 2006); Jensen, Kirkegaard and Laugesen (2006); Kirkegaard (2007). The latter author stresses the theoretical and methodological incompleteness of the current framework used to describe offshoring choices by companies within a globalizing world economy and, implicitly, its distortionary effects on the ongoing political debate on offshoring.

² Limited research has been carried out to date on the relationship between offshoring and trade in services. The topic has been addressed, among others, by: Van Welsum (2004), OECD (2004), Amiti and Wei (2004), Pain and van Welsum (2004), van Welsum and Reif (2005, 2006), van Welsum and Vickery (2005), WTO (2005). However, services trade flows have been tackled mainly in the context of analyses on the labour force effects of offshoring in developed countries, and have been treated only marginally from the angle of host countries.

³ According to our knowledge, only few attempts have been made thus far to investigate services offshoring in these countries. Apart from the contribution by Stare and Rubalcaba (2005), which addresses specifically services offshoring in the NMSs, the few number of studies dealing with offshoring in the context of EU enlargement are only tangentially discussing services offshoring, being focused primarily on manufacturing. Cases in point are: Hunya and Sass (2005), Marin (2006), and some recent studies undertaken at the European level (e.g. European Commission, 2006).

⁴ In part, these are opinions expressed with the occasion of the First Romanian BPO Conference, organized by Ziarul Financiar in partnership with Genpact on June 13, 2007 in Bucharest.

⁵ Quoted from Kirkegaard (2007, p.2).

⁶ According to frequently cited estimates by McKinsey&Company (2005), the size of the global market for outsourced IT and business process services has been close to USD260 billion in 2001. USD227 billion is estimated to represent domestic outsourcing. The value of offshored IT and business service activities are put at USD32 billion, while two-thirds of all offshoring is estimated to be captive offshoring.

⁷ Quoted from Amiti and Wei (2004, p.18). For similar conclusions, see: van Welsum and Reif (2005, 2006), Jensen, Kirkegaard and Laugesen (2006), Kirkegaard (2005, 2007).

⁸ According to standard economic theory, an economy should benefit overall from services offshoring and the increased specialisation it brings about, provided it is capable to adjust, by facing the short-term costs implied (e.g. under the form of job losses). Ultimately, the efficiency and productivity gains achieved through offshoring in the long term would enhance the overall growth and employment opportunities of both the home and host economies. Nevertheless, some economists are questioning the beneficial effects of services offshoring particularly for the developed countries. They argue that offshoring is going to change the current patterns of specialisation, by which developed countries are assumed to have traditionally a comparative advantage in knowledge and high-skill intensive goods and services. In other words, precisely in those areas in which Western companies are now facing increasing competition from developing and transition countries endowed with abundant and relatively cheap high-skilled labour, which can be now traded globally thanks to ICTs (van Welsum and Reif, 2005).

⁹ See, among others: Amiti and Wei (2004), UNCTAD (2004), WTO (2005), van Welsum and Reif (2005), Hunya and Sass (2005), Kirkegaard (2005, 2007).

¹⁰ Evidently, the issues and concepts implied in the phenomenon would require a more rigorous qualification. It is, however, out of the scope of this paper to enter the “offshoring” *versus* “outsourcing” debate. We only wish to stress that we assume the importance of keeping “offshoring” and “outsourcing”

decisions distinct – as location choice and mode choice decisions respectively, along with Markusen (2005, p.20).

¹¹ There is no commonly accepted terminology for describing the phenomenon. Hence, the terms used for its conceptualization differ greatly across the authors, even though their meanings are often very close, or are even overlapping. Offshoring, outsourcing, offshore/international outsourcing, cross-border outsourcing, insourcing, inshoring, nearshoring, externalisation, relocation, delocalisation, international sourcing, production fragmentation/relocation, global sourcing and global supply chain management – are some of the most frequently used terms.

¹² The shortcomings of the current statistical systems, as well as the inherent pitfalls in tracking and measuring services offshoring activities have been largely addressed in: OECD (2004), Amity and Wei (2004), WTO (2005), van Welsum and Reif (2005; 2006), Kirkegaard (2005;2007), etc.

¹³ See, for instance: OECD (2004), Amity and Wei (2004), van Welsum (2004), WTO (2005), van Welsum and Reif (2005, 2006), Stare and Rubalcaba (2005).

¹⁴ Although the included services cover a wide range of activities which may differ in various respects (such as information services, accounting, auditing, research and development, call centres, transcription services, etc.), a common characteristic of these services is that their provision relies generally upon the expertise of the supplier i.e. proven experience, know-how and skills are used to meet a client's needs. Hence, exports in business services might be broadly defined as the sale of knowledge and skill by a resident of Romania to a resident of another country (Ghibutiu, 2002).

¹⁵ Business process (outsourcing) services – BPO – may be subdivided further into: front-office services or customer interaction services (typically performed by call centres) and back-office services (performed by shared services centres). The boundaries between IT services and BPO are difficult to draw. Mattoo and Wunsch (2004). provide a useful list of the most common offshored IT and BPO services activities.

¹⁶ Only few countries (i.e. the United States, the EU and Japan) have such statistics. Many surveys confirm that at present, most offshoring takes the form of captive offshoring. However, the use of affiliated trade as a proxy for the level and/or rate of expansion in captive offshoring is controversial. While some authors argue in favour (e.g. Amity and Wei, 2004), the WTO (2005) considers affiliated trade to be a poor proxy for captive offshoring, as BoP (and TNCs sales through affiliates) data tend to overstate the size and growth of captive offshoring.

¹⁷ Local sales of foreign affiliates in partner countries (GATS mode 3) are not included in BoP data. Further, delivery of services by Romanians employed abroad (GATS mode 4) are considered as Romanian exports only as long as these employees have not become residents of the host country. They appear under the heading “work remittances” in the BoP statistics. Employees staying abroad for more than one year are considered residents of the host country. Thereafter, their earnings are no longer counted in the BoP statistics, but appear in the form of “worker's remittances”. Neither of the two BoP categories do make the distinction between services and manufacturing flows respectively.

¹⁸ Among the top eleven ranked Germany (with 38.3 per cent), Italy (37.3 per cent) and Spain (35.0 per cent), while Ireland was the only old EU member state ranking in the bottom eleven (with 12.5 per cent).

¹⁹ Romania continues to rank behind the other EU member states in terms of information society indicators. According to Economist Intelligence Unit's (2006) assessment, Romania ranks 10 in Eastern Europe (behind Bulgaria), and only 49 worldwide (among 68 countries) in terms of information society readiness.

²⁰ The Global Services Location Index (GSLI) evaluates 50 countries as potential locations for the most common remote services, including IT services and support, contact centres and back-office support. Each country's score is comprised of a weighted combination of relative scores on over 40 individual metrics,

which are grouped into three categories: financial attractiveness (labour and other costs); people skills and availability (labour force availability, education and language skills); and business environment (country environment, infrastructure). See: A.T. Kearney (2006).

²¹ Within the three components of the index, Romania ranks 19 at financial attractiveness, surpassed only by Bulgaria in the CEE region. It ranks 45 at people skills and availability (despite high ranks for education and language skills, it has a relatively small BPO industry and low labour force availability). In terms of business environment, it ranks 30, i.e. last position among CEE countries (due to low scores for the economic and political environment, infrastructure and intellectual property protection) (A.T.Kearney, 2007b).

²² While total hourly labour costs (i.e. wages and non-wage costs) in the EU-27 rose at an annual rate of 3.7 per cent in nominal terms in the first quarter of 2007, compared with the same quarter of 2006, Romania recorded with 25.0 per cent the second highest increase in terms of total hourly labour costs among the EU member states, being exceeded only by Latvia (32.6 per cent). Romania was followed by: Lithuania (22.2 per cent), Estonia (21.1 per cent), Bulgaria (15.9 per cent), and at a larger distance by Hungary (9.0 per cent), the Czech Republic (8.4 per cent) and Slovakia (5.9 per cent). It is also noteworthy, that after the relative constant labour cost increases (of around 17 per cent, on an annual basis) during the first three quarters of 2006, Romania recorded a sharp upward trend since the last quarter of 2006 (with a 29.9 rise), exceeding by far all other NMSs (Eurostat, 2007c).

²³ Like other East European countries, Romania has been so far a rather insignificant player in the global market for offshored IT and ICT-enabled services. According to McKinsey&Company (2006), Romania together with the Czech Republic, Hungary, Poland, Russia and Ukraine, accounted for a tiny fraction (i.e. USD 0.9 billion) of the global market for offshored services (including IT and business process offshoring, both captive and outsourced), estimated at USD 30 billion in 2003. In the same year, India accounted for USD 12.2 billion, Ireland for USD 8.6 billion, and China for USD 3.4 billion.

REFERENCES

- Amiti, M., Wei, S-J. (2004), Fear of Service Outsourcing: Is It Justified?, National Bureau of Economic Research, NBER Working Paper Series, Cambridge. Available at: <http://www.nber.org/papers/w10808>.
- A.T. Kearney (2006), Building the Optimal Global Footprint, A.T. Kearney's Global Services Location Index, Chicago. Available at: <http://www.atkearney.com/main.taf?p=5.3.1.143>.
- A.T. Kearney (2007a), Offshoring for Long-Term Advantage, The A.T. Kearney's Global Services Location Index, Chicago, http://www.atkearney.com/shared_res/pdf/GSLI_2007.pdf.
- A.T. Kearney (2007b), Global Services Location Index (GSLI), Romania in the Global and Regional Context, presentation at the First Romanian BPO Conference, 13 June, Bucharest.
- ARIS (2006), The Romanian Agency for Foreign Investment – ARIS, Annual Report 2006. Available at: www.arisinvest.ro/assets/pdf/raport2006_ro.pdf
- ARIS (2006), The Romanian Agency for Foreign Investment – ARIS, Monitored Projects 2004-2006. Available at: www.arisinvest.ro
- Balassa, B. (1965), Trade Liberalization and “Revealed” Comparative Advantage, The Manchester School, 33, pp.99-123.
- Brainbench, Inc. (2006), Global Skills Report - 2006, Talent in the 21st Century. Available at: http://brainbench.com/static/pdf/globalskills/Brainbench_GlobalSkillsReport2006.pdf
- Economist Intelligence Unit (2006), cited in: <http://www.bizcity.ro/it-c/romania-pe-locul-49-in-topul-eui-23376.html>.
- European Commission (2006), Enlargement, Two Years After: An Economic Evaluation, Occasional Papers, No. 24, May 2006. Available at: http://ec.europa.eu/economy_finance/publications/occasional_papers/2006/occasionalpapers24_en.htm
- Eurostat (2007a), Statistics in Focus, No.74/2007, Exports of Business Services. Available at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-07-074/EN/KS-SF-07-074-EN.PDF
- Eurostat (2007b), Online Database, February 2007. Available at: http://www.eds-destatis.de/en/tdm/downloads/2007_02/labourcosts_annualdata.xls
- Eurostat (2007c), Euro-Indicators, News Release, 83/2007, 14 June 2007.
- Eurostat (2007d), Newcronos. Available at: http://epp.eurostat.ec.eu.int/portal/page?_pageid=1996.45323734&_dad=portal&_schema=PORTAL&_screen=welcomeref&_open=/&_product=EU_MAIN_TREE&_depth=1
- Ghibutiu, A. (1999), Considering the Contribution of Services to Economic Growth and Development in Emerging Market Economies. The Case of Romania, paper presented at the World Services Congress 1999 on “Services: Generating Global Growth and Opportunity”, November 1-3, 1999.
- Ghibutiu, A. (2002), Assessment of Business Services Development in Romania, in: Eva Kigyossy-Schmidt (Ed.), Business Related Services in Central and Eastern Europe. A Cross Country Approach, Deutscher Universitaets-Verlag GmbH, Wiesbaden, Germany, 2002, pp.201-234.
- Hunya, G., Sass, M. (2005), Coming and Going: Gains and Losses from Relocations Affecting Hungary, WIIW Research Reports 323, Forschungsberichte Wiener Institut für Internationale Wirtschaftsvergleiche, November, Wien.
- Huws, U., Dahlmann, S., Flecker, J. (2004), Outsourcing of ICT and Related Services in the EU. A Status Report, European Foundation for the Improvement of Living and Working Conditions. Available at: <http://www.fr.eurofound.eu.int/publications/files/EF04137EN.pdf>
- Jensen, P.D., Kirkegaard, J.F., Laugesen, N., S. (2006), Offshoring in Europe – Evidence of a Two-Way Street from Denmark, Institute for International Economics, Working Paper Series WP 06-3, June 2006, Washington.
- Kirkegaard, J.F. (2005), Outsourcing and Offshoring: Pushing the European Model Over the Hill, Rather Than Off the Cliff!, Working Paper Series Number WP 05-1, March, Institute for International Economics, Washington, D.C.
- Kirkegaard, J.F. (2007), Offshoring, Outsourcing, and Production Relocation – Labour-Market Effects in the OECD Countries and Developing Asia, Peterson Institute for International Economics, Working Paper Series WP 07-2, April 2007, Washington.

-
- Marin, D. (2006), A New International Division of Labour in Europe: Outsourcing and Offshoring to Eastern Europe, Discussion Paper No.5447, Centre for Economic Policy Research, London, UK.
- Markusen, J. (2005), Modelling the Offshoring of White-Collar Services: From Comparative Advantage to the New Theories of Trade and FDI, National Bureau of Economic Research, Working Paper Series, 11827, Cambridge. Available at: <http://www.nber.org/papers/w11827.pdf>.
- Mattoo, A., Wunsch, S. (2004), Pre-Emptying Protectionism in Services. The WTO and Outsourcing, Policy Research Working Paper, 3237, The World Bank, March, Washington, D.C.
- McKinsey&Company (2005), The Emerging Global Labor Market, McKinsey Global Institute, June, San Francisco. Available at: www.mckinsey.com/knowledge/mgi.
- McKinsey&Company (2006), Hoch, D., Kwiecinski, M., Peters, P., The Overlooked Potential for Outsourcing in Eastern Europe, McKinsey&Company. Available at: http://www.mckinseyquarterly.com/The_overlooked_potential_for_outsourcing_in_Eastern_Europe_abstract
- National Bank of Romania, Balance of Payments Statistics (1995-2007).
- National Trade Register (2007), Companies by FDI, Statistical Synthesis, available at www.onrc.ro/romana/statistici/php
- NIS (2006), Annual publication of the National Institute of Statistics (NIS) from Romania, Results and Performance of Enterprises in Trade and Services.
- OECD (2002), Manual on Statistics of International Trade in Services, joint publication of the United Nations, the IMF, the OECD, the European Commission, the UNCTAD, and the WTO, pp.31-32.
- OECD (2004), OECD Information Technology Outlook 2004, Paris.
- Pain, N., van Welsum, D. (2004), International Production Relocation and Exports of Services, OECD and Birkbeck College, February, London.
- Panturu, S. (2007), Romania pe harta companiilor din TOP 100 Infotech, in: Romania Business Week, No.54/17 July 2007.
- Stare, M., Rubalcaba-Bermejo, L. (2005), Outsourcing of Services from CEEC - Current Potentials and New Challenges, in: Growth, Employment and Location of Services: New Trends in a Global World, Volumen 1: Proceedings of RESER 2005, Granada, Spain, pp. 285-313.
- Stefan, A. (2007), Locul 3 in regiune dupa cota unica, in: Romania Libera, 1 august, 2007.
- UNCTAD (2004), World Investment Report – 2004, The Shift Towards Services, United Nations, New York and Geneva.
- Van Welsum, D.(2004), In Search of “Offshoring”: Evidence from US Imports of Services, Birkbeck Economics Working Paper 2004, No.2, Birkbeck College, London.
- Van Welsum, D. and Reif, X. (2005), The Share of Employment Potentially Affected by Offshoring – An Empirical Investigation, DSTI Information Economy Working Paper, DSTI/ICCP/IE(2005)8/FINAL, OECD, Paris.
- Van Welsum, D., Reif, X. (2006), Potential Impacts of International Sourcing on Different Occupations, DSTI/ICCP/IE(2006)1/FINAL, OECD, Paris.
- Van Welsum, D., Vickery, G. (2005), Potential Offshoring of ICT-Intensive Using Occupations, DSTI Information Economy Working Paper, DSTI/ICCP/IE(2004)19/FINAL, OECD, Paris.
- WIIW (2006), Handbook of Statistics - 2006, Central, East and South-East Europe, The Vienna Institute for International Economic Studies, Vienna.
- WTO (2005), World Trade Report 2005, Exploring the Links Between Trade, Standards and the WTO, Geneva.

APPENDIX

Appendix Table 1
CIS and OBS categories: Correspondence between the Extended BoP Services Classification
and Romania's BoP

Position	Services categories according to the Extended BoP Services Classification ¹	Position	Services categories according to Romania's BoP ²
7	Computer and information services (CIS)	5	Computer and information services (CIS)³
7.1	Computer services	...	...
7.2.	Information services, including news agency services and other information provision services	...	...
9	Other business services (OBS)	...	Other business services (OBS)
9.1	Merchanting and other trade-related services	7	Merchanting and other trade-related services
9.2	Operational leasing services	8	Operational leasing services
9.3	Miscellaneous business, professional, and technical services	12	Other services
9.3.1	Legal, accounting, management consulting, and public relations	12.1	Legal, accounting, management consulting, and public relations
9.3.2	Advertising, market research, and public opinion polling	12.2	Advertising, market research, and public opinion polling
9.3.3	Research and development	12.3	Research and development
9.3.4	Architectural, engineering, and other technical services	12.4	Architectural, engineering, and other technical services
9.3.5	Agricultural, mining, and on-site processing services	12.5	Agricultural, mining, and on-site processing services
9.3.6	Other business services	12.6	Other business services, including services between related enterprises, n.i.e.
9.3.7	Services between related enterprises, n.i.e.	...	...

Note: ¹ Provided by the Manual on Statistics of International Trade in Services (2002); ² At the current level of aggregation of Romania's BoP data; ³ Computer and information services are aggregated.

Source: OECD (2002), Manual on Statistics of International Trade in Services, joint publication of the United Nations, the IMF, the OECD, the European Commission, the UNCTAD, and the WTO, pp.31-32; Balance of Payments statistics of the National Bank of Romania (2007).

Appendix Table 2
Romania's trade in goods and services, average annual growth rates, 1995-2006
(in nominal terms, in EUR and %)

	1995-2006	1995-2000	2000-2006	2000-2004	2004-2006
Goods					
Exports	14	14	15	14	16
Imports	16	13	19	17	24
Services					
Exports	16	13	20	11	37
Imports	14	10	17	9	33
Offshorable services					
Exports	34	44	31	15	64
Imports	17	19	16	5	20
CIS					
Exports	72	103	46	25	87
Imports	79	85	75	24	176
OBS					
Exports	34	41	29	13	59
Imports	14	18	12	9	17

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

Appendix Table 3
Romania's services balance by main components, in 1995-2006
(in EUR million)

Years		Total services, of which:	Transport	Travel	Other services
	Credit	1155	364	456	335
1995¹	Debit	1407	467	539	401
	Net	-252	-103	-83	-66
	Credit	1899	687	390	822
2000¹	Debit	2167	682	462	1023
	Net	-268	5	-72	-201
	Credit	2270	925	404	941
2001¹	Debit	2398	818	501	1079
	Net	-128	107	-97	-138
	Credit	2482	1020	354	1108
2002	Debit	2473	883	419	1171
	Net	9	137	-65	-63
	Credit	2671	1063	396	1212
2003	Debit	2609	997	423	1189
	Net	62	66	-27	23
	Credit	2903	1252	406	1245
2004	Debit	3116	1206	434	1476
	Net	-213	46	-28	-231
	Credit	4104	1189	852	2062
2005	Debit	4448	1583	750	2116
	Net	-344	-394	102	-54
	Credit	5513	1489	1034	2990
2006²	Debit	5507	1913	1035	2559
	Net	6	-424	-1	431
	Credit	3048	755	308	1985
Jan-May 2007	Debit	2731	900	384	1447
	Net	317	-145	-76	538

Notes: ¹ Data for 1995, 2000 and 2001, expressed in USD in the BoP statistics, have been transformed in EUR (ECU for 1995) at the following average annual exchange rates: 1 ECU=1.2932 USD in 1995; 1 EUR=0.9199 USD in 2000; 1 EUR=0.8956 USD in 2001; ² Provisional data for 2006 and January-May 2007.

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