

12. GLOBAL SOURCING OF SERVICES: HOW WELL ARE THE NEW EU MEMBER STATES COPING WITH THE CHALLENGES? (PART II)

Agnes GHIBUȚIU*
Simona POLADIAN**

Abstract

In the current debate on services offshoring, the New EU member states (NMS) have focused increasingly the attention of economists and politicians, as well as the public at large. Particularly in the light of the recent waves of EU enlargement these countries have been considered as highly attractive locations for offshored services both from a European and global perspective. While a fairly large amount of anecdotal evidence documents the NMS high potentialities in terms of services offshoring, academic research on this topic is limited. This paper aims to contribute to this discussion.

Drawing on recent literature on the complex issue of services globalisation, the paper investigates NMS trade and FDI flows in services over the 1995-2007 period to find evidence of enhanced offshoring-related activities in these countries. The focus is on NMS-10, i.e. NMS-12 excluding Cyprus and Malta. Given the shortcomings of available statistical data and instruments for gauging the scale and impact of services offshoring, the paper adopts a three-tier approach based on BoP trade and FDI statistics, complemented by alternative sources of information.

Notwithstanding the caveats associated with this kind of empirical exercise, the paper documents an accelerated pace of offshoring-related activities in the selected NMS, under both forms: international outsourcing and captive offshoring. Its findings show that the fastly growing exports in some individual services categories over recent years, coupled with the ongoing favourable changes in the structure and performance of NMS services trade are largely driven by enhanced offshoring activities hosted by their economies. Further, the paper highlights the NMS capabilities to cope with the challenges raised by the increasingly competitive global offshoring landscape, as

* Institute for World Economy, E-mail: agnesghibutiu@clicknet.ro.

** Institute for World Economy, E-mail: smpoladian@yahoo.com.

measured by competitiveness indicators. Finally, the findings of the paper confirm that current anecdotal information and consulting companies-based projections on NMS growing attractiveness as targets of offshoring decisions by TNC originating both inside and outside EU-15 are widely backed up by available statistical data. The paper is organised in two parts under the same title. See for Part I *Romanian Journal of Economic Forecasting, Volume X, No.1, pp. 123-135.*

Keywords: globalisation, services, international trade, FDI, New EU Member States

JEL classification: F02, L80, O52, O57

1. Services Offshoring in the NMS: Evidence from Trade Data

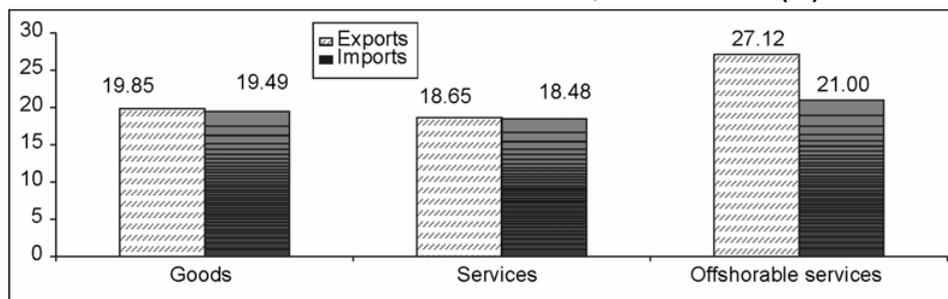
1.1. NMS trade in offshorable services

The dynamic developments revolving around certain services categories covered by the “other services” component of NMS trade in services in the more recent years are leading us to the assumption that these are related largely to enhanced services offshoring activities hosted by the NMS economies.

The arguments underpinning this assumption are arising from the analysis of the evolution and structure of the NMS “other services” component over the 2004-2007 period, which includes the wide variety of business-related services. It is also the area where tradables have been transformed due to the expanding influence of the internet (Havik and McMorrow, 2006, p. 14). Hence, it is here that we find the type of services which are most relevant for the offshoring process and which we suppose to include the two “offshorable” services categories, namely: “computer and information services” (CIS) and “other business services” (OBS), as defined in Section 1 ([Part I of the paper](#)).

Figure 5

Average annual growth (CAGR) of NMS exports/imports of goods, services and offshorable services, in 2004-2007 (%)



Note: In nominal terms, in EUR.

Source: Own calculations based on Eurostat data (2008).

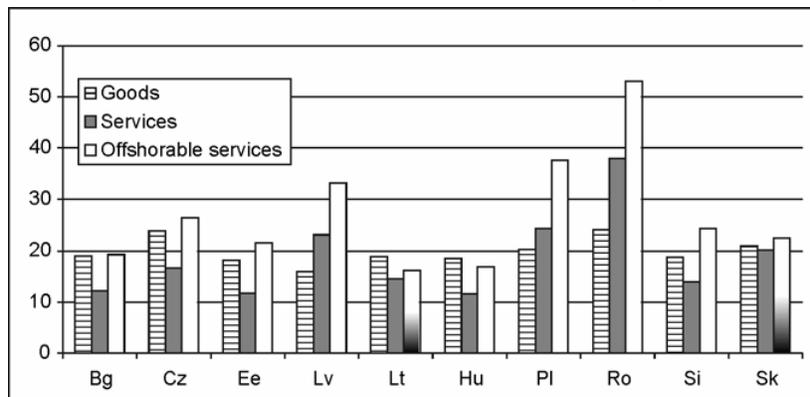
As seen in Figure 5, offshorable services exports increased dynamically over the 2004-2007 period, with their average annual growth rate (CAGR) for NMS as a group (27%) exceeding that of both goods (20%) and total services exports (19%). Offshorable services imports (21%) grew also faster than imports of goods and total services (19% and 18%, respectively), but remained below the growth of offshorable services exports.¹

In terms of CAGR of offshorable services exports over 2004-2007, Romania ranked first among the NMS (with 53%), followed at a larger distance by Poland (38%) and Latvia (33%) (Figure 6).

Due to the steady growth of offshorable services, their share augmented from 15% to 20% in total services exports during 2004-2007, and from 20% to 23% in the case of NMS imports as a group. Some countries have seen the respective shares increasing substantially, e.g. Romania from 22% to 30%, Hungary from 28% to 32%, Estonia from 18% to 23%, and Poland from 16% to 21%. In the case of offshorable imports, the highest increases in terms of share recorded Hungary (from 28% to 31%), Bulgaria (from 15% to 18%) and Slovenia (from 26% to 31%). In the case of Romania, for example, the respective import share diminished from 27% to 20% over 2004-2007.

Figure 6

Average annual growth (CAGR) of NMS exports of goods, services and offshorable services, in 2004-2007 (%)



Note: In nominal terms, in EUR.

Source: Own calculations based on Eurostat data (2008).

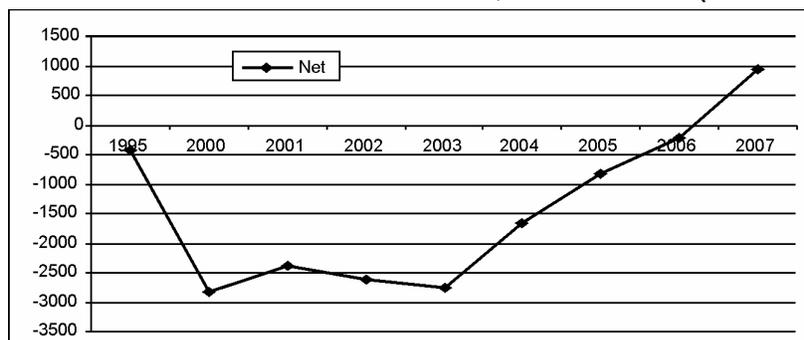
¹ Several NMS rank among the countries with the highest exports/imports growth of CIS and OBS in 1995-2004 worldwide, which may well reflect their emergence as offshoring locations. In terms of CAGR of cumulative exports of CIS and OBS, Latvia ranked 1st (with 55%), Estonia 5th (33%), Romania 6th (32%) and Lithuania 7th (29%), exceeding even India (ranked 8th, with 28%). As regards the respective imports growth, Latvia ranked 1st (with 35%), Lithuania 2nd (26%) and Estonia 3rd (25%), followed at a large distance by Romania (ranked 17th with 13%) (van Welsum and Reif, 2006, p. 6).

Finally, drawing conclusions solely on the basis of trends in NMS offshorable services exports is not appropriate since exports are only one part of the equation. When we also take into account imports of offshorable services, we get a clearer picture of NMS upsurge in offshorable services trade. Giving greater prominence to the net position is also appropriate since this measure generally cancels out many of the inconsistencies which can plague the individual series for exports and imports of services (Havik and McMorro, 2006, p. 15).

Figure 7 highlights the evolution of NMS net position (i.e. exports less imports) in offshorable services over the 1995-2007 period. It shows that noteworthy changes occurred in these countries as a group in respect of the offshorable services categories' trade performance. The dynamic growth of NMS offshorable services categories over 2004-2007, combined with the relatively slower expansion of the respective imports have triggered a first turnaround in their net balance on trade in offshorable services as a group in 2003, when chronic deficits started to diminish, followed by a more spectacular one in 2006, when deficits turned into growing surpluses. However, it is important to mention that treating NMS as a group hides important differences between individual countries as regards their overall capabilities to generate net exports.

Figure 7

NMS net trade in offshorable services, in 1995-2007 (EUR mn)



Note: In nominal terms.

Source: Own calculations based on Eurostat data (2008).

From the above analysis it may be concluded that NMS trade in offshorable services has clearly gained momentum in the more recent years, which might be put on account of highly dynamic offshoring activities unfolding in these countries over 2004-2007. Moreover, the remarkable expansion of their offshorable services exports has been accompanied by favorable developments in terms of trade performance. While these findings are supportive of our assumption that offshoring activities have generated more trade flows in the NMS, not all trade in these services categories is related to offshoring and nor is it possible to distinguish which part of it is (van Welsum and Reif, 2005, p.8). However, we may consider the resulting trade as an upper limit for the estimated value of offshored services, along with the WTO (2005, p. 275).

1.2. Offshorable versus offshored services

While BoP trade data as such do not allow us to find out how much of NMS offshorable services exports has been really generated by the offshoring phenomenon, we may find some relevant hints when looking into the Eurostat enterprise-level statistics related to the business services sector (Eurostat, 2007).

Data on business services exports derived from a voluntary survey carried out in 2005 (reference year 2004) among selected EU-27 countries reveal that “outsourcing driven demand” (i.e. international outsourcing) is a main reason for exporting by companies in the business services sector. As seen in Table 1, the share of companies declaring “outsourcing” as a reason for their exports is quite significant in Poland (88%), Romania (52%) and Slovakia (42%). The affiliation of business services providers to TNC (i.e. captive offshoring) seems to be also an important driver of exports in Latvia (29%), Slovakia (19%) and Poland (18%).

When linking the Eurostat enterprise-level data with the BoP data, we may conclude that already in 2004 a large proportion of NMS business services exports has been associated with the offshoring process. Without any doubt, services offshoring has generated even more exports in the NMS in the more recent years under the form of international outsourcing², but also its captive form, as suggested by the surge of FDI inflows in all NMS.

Table 1

**Reasons for exporting business services¹, by selected NMS, in 2004
(share of exporting enterprises, in %)**

	Total	Lv	Lt	Pl	Ro	Si	Sk
Products are cutting edge or specialised niche services	47	59	33	14	13	35	32
Enterprise belongs to a multinational enterprise group	22	29	15	18	10	8	19
The domestic market is too small	18	43	33	52	16	39	18
Internet driven demand	14	18	7	14	4	12	5
Outsourcing driven demand	12	4	9	88	52	16	42
Other reasons	25	13	11	9	9	13	7

Note: ¹ Defined according to NACE Rev.1.1 System of classification (K72.10, K74-50).

Source: Eurostat (2007).

1.3. How competitive are NMS?

A combination of cost-related as well as non-cost factors, including relatively low labor costs, availability of highly skilled and multilingual workforce, modern ICT frameworks, is behind NMS intrinsic advantages as desirable targets for companies' offshoring decisions in the increasingly competitive global setting. Geographical proximity to EU-15 markets, linguistic traditions, historical ties and cultural affinity are further

² Survey-based data on Romanian IT services companies for 2006 confirms the fast expansion of international outsourcing (i.e. on contractual base). While this form of offshoring has a very long tradition among Romanian companies, there is no doubt that it has substantially accelerated over the recent years (Ghibuțiu et al., 2007, p. 42).

enhancing their competitive advantage over popular low-wage locations in Asia or other parts of the world. There is no doubt, however, that the primary driver of NMS current attractiveness is their recent accession into the EU, even though full EU membership will bring about in the mid and long-term an erosion of their cost advantages (Ghibuțiu and Dumitriu, 2008, p. 208).

A key issue to be addressed in this chapter is how well are the NMS suited to cope in the rapidly changing global environment where the new competitors which have emerged across the world hold a broad array of comparative advantages in high value added services industries (e.g. India, China, Malaysia, Thailand, Brazil, Indonesia, etc.). Moreover, both the emerging economies and the individual NMS share specialisation patterns in areas of services trade which have similar skill and factor intensities. Hence, these countries are strong competitors for the NMS. But apart from intensified competition from other low-wage economies, the NMS are also confronted with growing competitive pressures from their very counterparts in the context of the recent waves of EU enlargement. It may be argued that competition across NMS is even more pronounced, given that they are competing in the same range of services products. This is why in our attempt to gauge NMS competitiveness in the global offshoring market, we focus primarily on the competitive strength of individual NMS countries within the NMS as a group.

What follows is an assessment of NMS competitiveness based on revealed comparative advantage (RCA). Applying the classic Balassa RCA index to NMS offshorable services categories, we measure each individual country's export share in the offshorable services exports share of NMS as a whole.

If x_{ki} represents offshorable services exports from country k then RCA index is:

$$RCA_{k,i} = \frac{x_{ki} / \sum_i x_{k,i}}{x_{NMS} / \sum_i x_{NMS,i}}$$

where the subscript NMS refers to the rest of countries, i.e. total NMS exports excluding country k . The greater the value of the RCA, the greater the relative weight that the offshorable exports has in country k 's services export basket.

Table 2

RCA indices in the offshorable services categories in NMS, in 2004 and 2007

	Bg	Cz	Ee	Lv	Lt	Hu	Pl	Ro	Si	Sk
2004	0.57	0.95	0.97	0.78	0.40	1.70	0.81	1.21	0.89	1.08
CIS + OBS										
2007	0.56	0.98	1.01	0.79	0.33	1.49	0.90	1.36	0.93	0.91
2004	0.33	0.66	0.66	1.19	0.62	1.64	0.63	1.99	1.37	1.55
CIS 2007	0.58	1.24	1.00	0.84	0.20	1.33	0.64	2.00	0.83	0.89
2004	0.61	0.99	1.02	0.73	0.37	1.71	0.83	1.12	0.83	1.03
OBS 2007	0.55	0.94	1.01	0.79	0.36	1.51	0.94	1.27	0.94	0.92

Note: CIS and OBS as defined in **Section 1 (Part I)**.

Source: Own calculations based on Eurostat data (2008).

The resulting RCA indices for 2004 and 2007 are displayed in Table 2. These are assumed to reflect the competitiveness of individual NMS in offshorable services relative to NMS as a group. Accordingly, we may conclude that three NMS - i.e. Hungary, Romania and Estonia - reveal a comparative advantage in total offshorable services in 2007. These countries are experiencing even an increase of their comparative advantages as against 2004, except for Hungary.

Breaking down the offshorable services category into its two components (as defined in Section 1), we may observe that Romania, Hungary, the Czech Republic and Estonia appear to be competitive in computer and information services (CIS) in 2007. Further, these countries are recording an upward move in 2007 as compared to 2004, except for Hungary and Latvia. In the case of other business services (OBS), again Hungary, Romania and Estonia have a comparative advantage over the rest of NMS in 2007, but only Romania shows an ascendant trend when compared with 2004.

Given the changing nature of global trading patterns, the rapid shifts in the revealed specialisations of different countries and the emergence of a number of large new trading powers in the field of services (e.g. India, China), it is important to see how the NMS are responding to these challenges.

The RCA indices presented in Table 3, calculated on the basis of Eurostat and WTO data, highlight the competitiveness of NMS in offshorable services relative to the EU-15 and India for the year 2006 (the latest available). The results of the assessment reveal that NMS are getting on fairly well from a European perspective, i.e. in relation to the EU-15. Moreover, some of them (i.e. Romania and Hungary) are even exceeding the EU-15 in terms of competitive strength. By contrast, the position of NMS on the global market for offshored services exhibits a quite notable vulnerability vis-a-vis their competitors (e.g. India).

Table 3

RCA indices in offshorable services¹ for NMS, EU-15 and India, in 2006

Bg	Cz	Ee	Lv	Lt	Hu	Pl	Ro	Si	Sk	NMS	EU15	India
0.48	1.07	0.90	0.66	0.53	1.30	0.87	1.34	0.85	0.86	0.97	1.21	2.83

Note: The sum of CIS and OBS as defined in Section 1 (**Part I**).

Source: Own calculations based on Eurostat (2008) and WTO (2008).

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

Global services offshoring is being driven largely via commercial presence, i.e. TNC seeking to take advantage of changes in worldwide specialisation patterns and the need to focus on the higher value added components of their production processes. Hence, TNC are continuously re-evaluating their operations at a global scale in order to make more effective use of the vast new and largely untapped pool of global labour available at relatively low cost.

2. FDI and Services Offshoring in the NMS

FDI plays an important role in services offshoring. In principle, FDI affects offshoring in two ways: through captive offshoring (by moving services from a parent company to its foreign affiliates), and when specialised services providers set up foreign affiliates to serve foreign clients (UNCTAD, 2004, p. 159). Actually, the bulk of all services offshoring (over two-third) is estimated to take place under the captive form (McKinsey&Co, 2005, p.15). But similarly to trade, FDI statistics are not adequately equipped to measure offshoring, and hence it is not possible to determine what share of FDI is directly related to it.

In the NMS, offshoring may be seen as a particular form of FDI. In the FDI literature it is identified as efficiency-seeking (or vertically integrated FDI), as opposed to market-seeking (or horizontally integrated FDI) Alternatively, export-oriented subsidiaries are set up by vertically integrated multinational companies in a host country with the aim to lower production costs or to seek, secure and diversify resources (Hunya and Sass, 2005, p.3). As services become more open to efficiency-seeking FDI, information-intensive services can be fully subjected to the international division of labour and hence integrated international production (UNCTAD, 2004, p. 152).

As mentioned above, FDI inflows have contributed greatly to upgrading the NMS economies, reversing the long-lasting bias against services and promoting their structural convergence towards the old EU member states. In the most advanced countries which are also the largest FDI recipients (Poland, Hungary, the Czech Republic), services had already become dominant in FDI in the late 1990s. Here, the industry composition of inward FDI has gradually shifted from manufacturing towards services, and within services, from network industries privatised in earlier years towards business-related services. In the NMS with slower progress in terms of structural adjustment, for example Romania and Slovakia, manufacturing retained a much higher share of FDI. By the end of 2005 (the latest available year for all NMS), the share of services in total inward FDI stock fluctuated between 43% in Slovakia and 69% in Estonia (Eurostat, 2008).

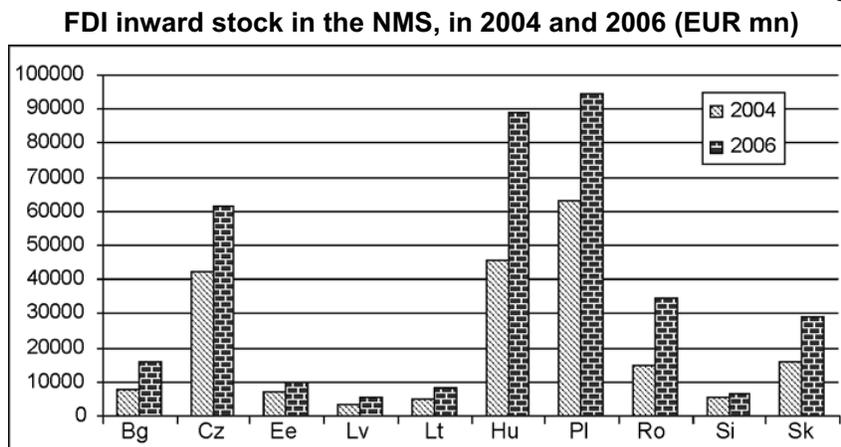
In general, in business services and R&D, FDI has played a relatively limited role until more recently. But the situation is likely to change, with many NMS experiencing currently increased FDI penetration in business services. According to Eurostat data (2008), the weight of business services (defined as the sum of computer activities, R&D and other business activities) in total inward FDI stock in the services sector ranged between 5% in Slovakia and Lithuania, and 25% in Hungary by the end of 2005. Apart from Hungary, relatively high percentage shares of business services may be found in Slovenia (20%), Estonia (18%), Latvia (13%) and the Czech Republic (11%), while in all other NMS the respective share lies between 5-10%. Evidently, these figures alone do not bring us very far in our analysis, as they do not tell us anything about the real extent of services offshoring via FDI.

The results of an examination of the number and destination of worldwide TNC projects in export-oriented services over 2002-2003 undertaken by UNCTAD (2004, p. 162-163) reveals that involvement of NMS in global projects has been rather insignificant in the respective years when compared to other popular destinations. At

the same time, the quantitative assessment of offshoring-related FDI projects shows a high concentration in three countries within the NMS as a group, namely: Hungary (26 projects), the Czech Republic (20) and Poland (15), followed at a large distance by Romania (7) and Slovakia (4). Bulgaria, Latvia and Lithuania received only 2 projects each, while to Estonia went a single project. Out of the total number of global FDI projects related to services offshoring (i.e. call centres, shared services centres, IT services and regional headquarters), the NMS accounted for only 4%, as against 32% and 34%, for example, held by the EU-15 and South-East Asia, respectively. Nevertheless, when the relative weight of each geographical region is taken into account, the performance of the NMS appears to be better, particularly as regards call centres and shared services centres (Stare and Rubalcaba, 2005, p. 297).

While there are no comparable data on global TNC projects in export-oriented services for the more recent years, when the NMS as a whole recorded a robust growth in offshorable services exports according to BoP trade statistics, we may get some broad insight into the pace and extent of offshoring-related FDI in these countries by combining several sources of information, i.e. official FDI statistics and data from private sources (e.g. company-related and media reports).

Figure 8



Source: Own calculations based on Eurostat data (2008).

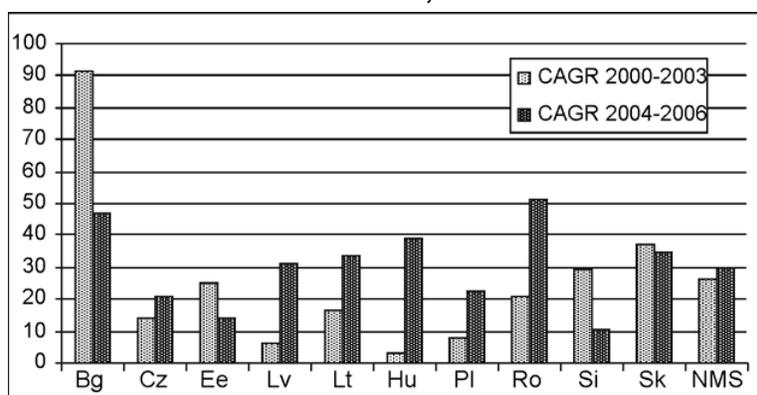
Available FDI statistics point towards highly dynamic FDI-related developments in all NMS over the last couple of years, which proves without any doubt an overall rise in these countries' attractiveness as targets of locational decisions by TNC originating inside and outside EU-15. This may support at least in part the assumption that captive offshoring has also gained momentum. The surge in FDI inflows in recent years reflects a notable intensification of foreign investors' activity in the NMS, which is sharply contrasting with the trends prevailing in some of these countries in the

earlier years.³ Subsequently, all NMS have seen important increases in their total inward FDI stocks in 2006 in comparison to 2004, as illustrated by Figure 8.

Figure 9 features the accelerated pace of inward FDI stock growth in the NMS, reflected by the 30% rise over 2004-2006 compared with the already high dynamics (26%) recorded in 2000-2003. Even more striking is their growth performance as a group when compared to that of EU-15 in the two sub-periods (11% and 9% respectively). When considering the NMS individually, outstanding growth rates of their inward FDI stocks over 2004-2006 experienced Romania (51%), Bulgaria (47%) and Hungary (39%).

Figure 9

Growth of FDI inward stock in the NMS, in 2000-2003* and 2004-2006 (%)



Note: 2001 for Hungary and Slovenia, and 1999 for Romania.

Source: Own calculations based on Eurostat data (2008).

The evolution of FDI inward stock as percentage share in GDP over 2004-2006 is even more relevant, as this indicator has the advantage of eliminating the effect of differences in the size of the NMS economies. As seen in Figure 10, all NMS (except Estonia) witnessed a significant rise in FDI inward stocks as percentage share in their GDP.

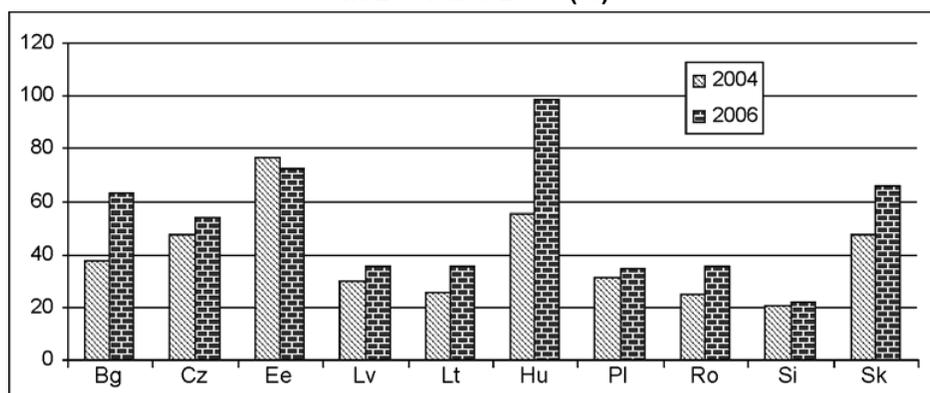
Recent changes in the industry composition of NMS inward FDI stock point also to intensified services-related FDI inflows. The breakdown of FDI stocks by economic activities shows, in general, an upward trend of FDI oriented towards the services sector, including those areas which are prone to offshoring - i.e. computer activities, R&D, and other business activities. In the four NMS for which comparable data for 2004-2006 at a disaggregated level are available (i.e. Lithuania, Poland, Romania and

³ A case in point is Romania. The dynamic growth of FDI over the last four years has no precedence. The average annual amount of FDI inflows increased over 4.7 times during 2004-2007, as against 2000-2003. After the significant turnaround in 2004, FDI rose sharply and reached its highest level ever in 2006 (EUR 9.1 billion). According to national BoP data, FDI inflows amounted to EUR 7.1 billion in 2007, bringing the value of total inward FDI stock to EUR 38 billion, equivalent to a 2.5 times increase compared to 2004 (Ghibuțiu, 2008, p. 61).

Slovenia), growth of FDI stock in business services was superior to that of total FDI and total services FDI, respectively. Further, all four countries have seen an increase of the percentage share of business services in their total services FDI stock in 2006 as compared to 2003 (for example, from 8% to 13% in the case of Poland) (Eurostat, 2008).

Figure 10

FDI inward stocks in the NMS as percentage share in GDP, in 2004 and 2006 (%)



Source: Own calculations based on Eurostat data (2008).

Certainly, the above figures provide only some rough support for the supposition that increased amounts of FDI directed towards business activities in the NMS might be attributed to intensified offshoring activities unfolding between their companies and those from the EU or the rest of the world. The sheer fact that almost 80% of NMS inward FDI stock is currently accounted for by investors originating from EU-15 suggests a high degree of corporate integration and intense offshoring activities taking place between these countries and the old EU member states. The validity of this observation even for earlier years has been documented by empirical research (e.g. Marin, 2006).⁴

⁴ The author relies on survey data on 666 German and Austrian companies with 2,200 investment projects in Eastern Europe during the 1990-2001 period (covering 100% of Austrian and 80% of German FDI in Eastern Europe). The findings show that on average 45% of German investment to Eastern Europe are offshoring activities of German firms. It is noteworthy that offshoring dominates among German investment in the Czech Republic – with a 76% share, Bulgaria – 72%, the Slovak Republic – 69%, and Romania – 64%. While only 17% of Austrian investment to Eastern Europe represent offshoring investments in the analysed period, the share of offshoring exceeds again the Eastern Europe average in the case of Poland – 42% and Romania – 24% (but is significantly lower than in Russia – 68%). Even if the analysis does not distinguish between manufacturing and services offshoring, its findings reveal the importance of offshoring-related investments in the NMS already in the 1990-2001 period, when FDI inflows into some of these countries (for example, Romania) were relatively low. The difference between Germany and Austria is explained by the high

However, these figures alone do not offer any point about the current level of FDI associated with services offshoring, as available statistics are not suitable to identify the precise share of FDI which is directly related to offshoring activities.

Hence, to take a step further our analysis, in the remainder of this chapter we provide some information from alternative sources to illustrate at least in the case of one NMS, specifically Romania, the strong linkage which seems to exist between official FDI data on the one hand, and data from other official sources and private ones, including media and company-level reports, on the other hand. The evidence from Romania in terms of services offshoring is all the more interesting, as the country's recent experience might bear relevance for many other NMS witnessing similar developments.

First of all, additional official information confirming the dynamic expansion of captive offshoring in Romania in the last years, especially in comparison with the early 2000s, is offered by the Romanian Agency for Foreign Investment (ARIS), responsible for monitoring major FDI projects. Out of the total 24 FDI projects assisted/monitored by ARIS in 2006 (with a cumulative investment value of EUR 469.7 million, and implying the creation of 6,060 new jobs), 5 projects involved services offshoring centres set up in Bucharest by Hewlett Packard, Microsoft, General Electric, Infineon and Wipro. These projects represented 21% of the total number of successful projects monitored by ARIS in 2006, and their share in total investment value and overall job creation amounted to 32% and 45%, respectively. By contrast, out of the 21 FDI projects monitored by ARIS during 2004-2005 (cumulative investment value of EUR 471 million/11,655 new jobs) none was related to services offshoring (Ghibuțiu and Dumitriu, 2008, p. 206).

Further information backing up the dynamic expansion of captive offshoring over the last years in the country comes from media and company reports, which remain basically the main source for monitoring the real trends in offshoring-related activities in the NMS, as well as elsewhere. The picture which arises when piecing together the scattered evidence from these alternative sources suggests that Romania is emerging as a new hub for services offshoring at the regional and global level alike. The short presentation in Box 1 is indicative of the impressive upswing of this process in recent years, especially under its captive form.

Box 1: Romania: a new hub for services offshoring?

According to professionals within the offshoring business, Romania is establishing itself as a prime location for offshored services, particularly for clients based in the EU-15 and the USA.

It is worth stressing that according to the UNCTAD (2004) assessment mentioned above, none of the 7 offshoring-related FDI projects oriented towards Romania in 2002-2003 involved shared services centres (back-office services), while Hungary received 7 such projects, the Czech Republic 6, and Poland 5. By contrast, during the first six months of 2006 only, three major global players set up almost simultaneously

share of manufacturing (57%) in Germany's offshoring investments to Eastern Europe, while Austrian investments are mainly in services (72%) (Marin, 2006).

their business process operations centres in Bucharest, namely Hewlett-Packard, Oracle and Microsoft. Actually, the total number of FDI projects concerning shared services centres which became operational during the year 2006 alone amounted to 6, which is a testimony to the country's increasing attractiveness. But call centres are also springing up steadily. Their number exceeded 250 in 2006, and according to estimates they are growing by 20-30 units each year.

Several global services providers, including the top 10, are already present on the Romanian market and more are likely to follow. Most of the TNC active on the domestic market started as market-seeking FDI already in the 1990s, and expanded later into efficiency-seeking FDI, including export-oriented projects. Experts within the offshoring business expect the local market for offshored services to grow significantly by 2008. This is in line with the argument put forward by Hunya and Sass (2005, p. 8), according to which there is still wide scope for further expansion of efficiency-seeking FDI in the NMS.

While Romanian officials put the size of offshoring-related FDI at EUR 200-250 million by 2010, estimates on both scale of investment and new jobs creation seem to be already exceeded, when taking into account the surge of FDI projects or the stepped-up pace on the local recruitment market. IT and business support services providers are currently the most active employers in the Romanian economy, and the rate of their recruitment is faster than in any other traditional industry. The big players have already employed several thousands of persons and announced further recruitments in the order of thousands in the near future.

Source: *Ghibuțiu (2008, p. 63-65)*.

At the same time, it may be argued that Romania is not a unique case within the group of NMS, and that many other countries experience similar developments. In fact, this argument is further supported by A.T.Kearney's (2007) country assessment which includes all analysed NMS (except Slovenia) among the top 50 most attractive services offshoring locations worldwide.⁵ Moreover, some of them are ranking even in the top 10 (like Bulgaria), while others (Slovakia, Estonia, the Czech Republic, Latvia and Poland) are also holding prominent positions.

3. Concluding Remarks

The findings of our empirical investigation largely support the view that the process of services offshoring has gained momentum in the NMS under both its forms: international outsourcing and captive offshoring.

⁵ A.T.Kearney's *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, across the world. 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 (2007).

The steady growth of services exports associated with potential offshoring activities, coupled with highly dynamic FDI flows into all NMS in recent years are indicative of the accelerated pace of this process as compared to the early 2000s. The briefly outlined experience of Romania based on information from the offshoring business further sustains this assertion.

While indirect measures derived from official trade and FDI statistics are not suitable to determine the real extent and impact of services offshoring, the findings of the paper widely back up existing anecdotal evidence on NMS increasing attractiveness as targets of offshoring decisions by companies originating both inside and outside EU-15

Services offshoring like globalisation in general, brings both economic benefits and costs to the countries implied. The benefits accruing to NMS as host countries seem to illustrate the classic gains from trade and specialisation: expansion of services exports, creation of new jobs, transfer of soft technology, increased competition and higher quality services.

The following conclusions deriving from our paper provide support to this view. Firstly, services offshoring has generated more trade in the NMS, mainly in new types of services and advanced services, respectively. It is the big growth area. Secondly, it contributed to improving the composition of services supplied internationally by expanding the share of high value added services. Thirdly, the NMS net position in offshorable services has moved from chronic deficits to growing surpluses over the most recent period. This shift towards structural surpluses in high value added services suggests that the NMS are beginning to move up the value added chain. And last but not least, increased business services exports have helped NMS to improve their external financial positions. Moreover, in some of them (e.g. Romania) these exports have triggered a historical trend reversal in terms of net services trade, by turning structural deficits into surpluses.

On the downside, increased offshoring might lead in the long-run to growing services imports and income transfers of TNC to their home countries, bearing additionally upon the current account deficits of NMS, which are already huge in most of them as percentage share in their GDP (e.g. Latvia, Bulgaria, Estonia, Lithuania, and Romania). But overall, the benefits seem to outweigh the implied losses, at least for the moment.

NMS are emerging as attractive locations for companies' international organisation of production and are collectively stepping forward to seize more and more of the global offshoring business. Notable differences exist, however, across NMS in terms of their competitive strength. Yet, a fast catching-up process is discernible in those NMS which are traditionally lagging behind the "old NMS" like Poland, Hungary or the Czech Republic.

Services offshoring and global economic integration create opportunities for growth and development, but also generate increased pressures on the NMS economies to adjust. The extent to which these countries will take advantage of the new opportunities in the future will depend on their ability to manage the challenges raised by the rapidly changing global offshoring landscape. Best suited are those NMS that will prove capable to adjust dynamically, by continual upgrading of their comparative

advantages, related primarily to human capital and business environment, but also by developing new ones.

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 (2007), Offshoring for Long-Term Advantage, The A.T. Kearney's Global Services Location Index, Chicago. Available at: http://www.atkearney.com/shared_res/pdf/GSLI_2007.pdf.
- Banca Națională a României, Statistici ale balanței de plăți (1990-2007).
- Eurostat (2007), Statistics in Focus, Industry, Trade and Services, Exports of Business Services, No.74/2007. Available at: http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-SF-07-074/EN/KS-SF-07-074-EN.PDF
- Eurostat (2008), Balance of payments – International transactions. Last consulted: in May 2008. Available at: http://epp.eurostat.ec.europa.eu/portal/page?_pageid=1996.45323734&_dad=portal&_schema=PORTAL&screen=welcomeref&open=/bop/bop_its&language=en&product=EU_MASTER_balance_of_payments&root=EU_MASTER_balance_of_payments&scrollto=0
- Ghibuțiu, 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*, Atlanta.
- Ghibuțiu, A. (Coord.), Boureanu, M., Pencea, S. et al. (2007), *Potențialul României ca țară de destinație pentru servicii relocalizate în plan european și global*, studiu IEM/INCE, Academia Română, București.
- Ghibuțiu, A. (2008), *Fenomenul relocalizării serviciilor și impactul său asupra economiei românești*, in: OECONOMICA, Societatea Română de Economie, IRLI, XVII(1): 41-80.
- Ghibuțiu, A., Dumitriu, I. (2008), Is Romania Emerging as an Attractive Location for Services Offshoring?, in: Birsan, M., Hunya, Siedschlag, I. (Editors), *Foreign Direct Investment, Economic Growth and Labour Market Performance: Empirical Evidence from the New EU Countries*, Editura Fundației pentru Studii Europene, Cluj-Napoca, 2008, pp. 195-210.
- Havik, K., Mc Morrow, K. (2006), Global Trade Integration and Outsourcing: How Well is the EU Coping with the New Challenges?, European Economy, European Commission, *Economic Papers* No.259, October 2006.
- 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, Vienna.
- Kirkegaard, J.F. (2005), *Outsourcing and Offshoring: Pushing the European Model Over the Hill, Rather Than Off the Cliff*, Institute for International Economics, *Working Paper Series* Number WP 05-1, March, Washington.
- McKinsey&Company (2005), *The Emerging Global Labor Market*, McKinsey Global Institute, June, San Francisco.
- McKinsey&Company (2006), Hoch, D., Kwiecinski, M., Peters, P., *The Overlooked Potential for Outsourcing in Eastern Europe*, McKinsey on IT, Winter, San Francisco.
- Marin, D. (2006), *A New International Division of Labour in Europe: Outsourcing and Offshoring to Eastern Europe*, *CEPR Discussion Paper* No. 5447, London.
- OECD (2004), *OECD Information Technology Outlook 2004*, Paris.
- 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*, Volume 1: Proceedings of RESER 2005, Granada, Spain, pp. 285-313.
- UNCTAD (2004), *World Investment Report – 2004, The Shift Towards Services*, United Nations, New York and Geneva.
- 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*, *Working Party on the Information Economy*, DSTI/ICCP/IE(2006)1/FINAL, OECD, Paris.
- WTO (2005), *World Trade Report 2005, Exploring the Links Between Trade, Standards and the WTO*, Geneva.
- WTO (2008), *Data base*. Last consulted: in May 2008. Available at:
<http://stat.wto.org/StatisticalProgram/WSDBStatProgramSeries.aspx?Language=E>