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TOURISM IN FUNCTION OF DEVELOPMENT OF THE REPUBLIC OF SERBIA

Tourism product as a factor of competitiveness of the Serbian economy and experiences of other countries

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THEMATIC PROCEEDINGS
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UNIVERSITY OF KRAGUJEVAC
FACULTY OF HOTEL MANAGEMENT AND TOURISM IN VRNJAČKA BANJA

PARTICULARITIES OF FOREIGN DIRECT INVESTMENT IN ROMANIAN SERVICES SECTOR

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Abstract

The paper is focused on the evolution of foreign direct investment at international level taking in account many changes which were imposed by globalization, international financial crisis and sustainable development. The challenges imposed by this phenomenon determined many quantitative and qualitative movements in the universe of foreign direct investment. The authors observed moving the interests of foreign investors from the secondary sector to the services sector, as these had major implications for the development of the host countries. Another issue that has been analyzed by the authors is the foreign direct investments in Romanian economy, especially in the services' sector. They identify the special service fields preferred by the foreign investors.

Key Words: *foreign direct investment, transnational corporations, services*
JEL classification: *A19, F20, F21, L80, L86*

Introduction

Foreign direct investment (FDI) is a force that shapes the world economy through different mechanisms which are used primarily by transnational corporations that are the promoter of foreign capital in host countries (Matei, 2004; Iacovoiu, 2009, Voica, 2016). In addition, new entities have been appeared as vehicles for FDI (UNCTAD, 2008; UNCTAD, 2014).

We note the implication of international financial organizations like International Bank for Reconstruction and Development, European Bank for Reconstruction and Development or International Financial

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Corporation that are very implicated in developing countries through different mechanism like credits or participation to capital of local companies.

Private equity firms are vehicles for FDI, too. The rationale for these investment firms is given by the inadequate capital supply of financial institutions and the high demand of capital for new or high-risk companies but also with great potential for development. Private equity therefore provides financing at a first stage or financing the expansion of these companies. The main target for these entities are unlisted companies, and the investment is made for a fixed period of time, in the form of equity, convertible or non-convertible debt securities, as well as shareholder loans.

Sovereign wealth funds (SWF) are state-owned investment funds that globally invest in real and financial assets. These governmental funds are funded by the accumulation of foreign exchange assets and have a higher risk tolerance than other entities managed by the national monetary authorities. The first sovereign wealth fund emerged in the 1950s, being set up by countries with significant natural resources. As their financial strength has increased, they have become aggressive investment vehicles. Since the outbreak of the international financial crisis, these investment funds have become a new force, having a complementary role to TNCs as important sources of investment in the developing world (UNCTAD, 2008).

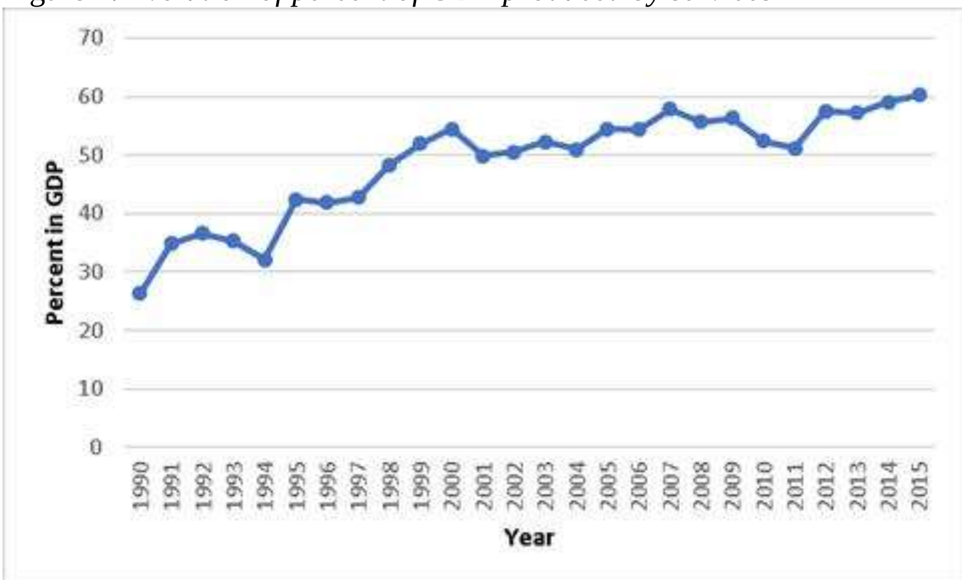
The competition between host countries in order to be more attractive for FDI is very intense because the public authorities are aware by the positive effects of the foreign capital on national economy. The benefits of FDI (Matei, 2004; Hübler, Michael; Keller, Andreas, 2008, Iacovoiu, 2009, Fu et al., 2010, Zaman et al. 2011; Javorcik, 2014; Voica et al. 2015, Iacovoiu, 2015) on export, work force, restructuring economies, competitiveness, technology transfer, labor productivity, sustainable development etc. are acknowledged by specialists, but also attract the negative effects that foreign capital can generate by balance of payments, environment pollution, bankruptcy of local firms due to increased competition or staff redundancies in the case of mergers and acquisitions of companies.

The economic importance of services

More and more specialized studies prove the importance of services in national economies and the international economy as well as the contribution of this sector to economic and social development (Rădulescu, 2008; Rădulescu & Dumbrăvescu, 2009; Iacovoiu et al., 2009; Sen, 2011; Noland et al., 2012; Park & Shin, 2012).

The specialists are talking about a service revolution or services as an *engine of growth* (Ejaz Ghani, 2010; Park & Shin 2012; Noland et al., 2012). These global structural changes are favored by the progress of telecommunication, increased training of workforce and connectivity. Moreover, the characteristics of services have also changed substantially under the influence of these determinant factors and have become transportable, tradable, and scalable. So, the services are a commodity that are could be traded on national markets or exported and imported. We can discuss about splintering and disembodiment of services.

Figure 1: *Evolution of percent of GDP produced by services*



Source: *Author own from World Bank*

The revolution of services based on technology, transportability and tradability are the 3T global forces that shape the production and trade of services. So, IT advances have allowed services to be delivered without the need for physical contact between producers and consumers, have removed barriers and reduce transaction costs.

As demonstrated by the data presented in the tables below, which include information provided by the World Bank, the services have a direct contribution to GDP, job creation, supply of inputs to other economic sectors (OECD, 2008). Globally, the services account for about 68.5% of GDP, with major differences across countries depending on the level of development. If in developing countries in Africa, the share of services in GDP is 25-30%, in developed countries the weights are higher than the international average (in Hong Kong 92.6%, United Kingdom 79.2%).

Table 1: *Services, value added (% of GDP)*

	1995	**2014**
Romania	42.5	59.0
Central Europe and the Baltics	56.4	63.1
Euro area	67.9	73.9
European Union	67.6	74.0
USA	NA	78.0
World	58.6	68.5

Source: *World Bank*

OECD specialists have even noticed that the process of economic development is accompanied by an increased role of services in the economy coupled with a decline in the share of agriculture.
Analyzing data published by the World Bank, we note that the leadership position in the US, which holds a 78.0% of the added value generated by the service sector in 2014, is even higher than the one recorded at EU level.

Table 2: *Services, value added (constant 2010 million US$)*

	1995	**2014**
Romania	NA	91,853.58
Central Europe and the Baltics	NA	792,261.06
Euro area	6,124,444.60	8,569,041.05
European Union	8,013,433.23	11,666,775.30
USA	-	12,175,169.21
World	26,569,977.13	45,457,495.05

Source: *World Bank*

The contribution of services to the economic development of a country is accompanied by an increase in the share of this sector in the total employment. Countries which are characterized by important contributions from the tertiary sector to GDP creation also have a significant labor force concentration in this sector.

Table 3: *Employment in services (% of total employment)*

	2005	**2010**
Romania	37	41
Central Europe and the Baltics	52	56
Euro area	67	71
European Union	66	69
USA	78	80
World	43	47

Source: *World Bank*

The contribution of services to economic development can also be strengthened by increasing trade in services. The data published by the World Bank reveal the growth of trade in services (as a share of GDP), especially in the case of European countries, which also contributed to the augmentation of the figures in the world.

Table 4: *Trade in services (% of GDP)*

	1995	**2015**
Romania	8.9	16.5
Central Europe and the Baltics	16.2	21.0
Euro area	10.4	23.5
European Union	10.8	22.9
USA	4.7	6.9
World	8.6	13.0

Source: *World Bank*

Export of services creates opportunities for those countries that have some advantages in sectors such as IT services or tourism services, which therefore extends outputs of services in sectors and creates new jobs.

Table 5: *Service exports (BoP, current million US$)*

	1995	**2015**
Romania	1,503.00	18,459.74
USA	219,193.00	750,862.00

United Kingdom	79,796.04	351,150.01
China	19,130.30	286,539.71
Germany	75,971.00	264,461.85
France	92,121.39	241,468.23
Central Europe and the Baltics	37,225.85	160,354.69
Euro area	451,755.91	1,404,914.91
European Union	585,947.34	2,021,246.84
World	1,298,180.71	4,976,944.44

Source: *World Bank*

International commerce with service – both on the export and import side– is dominated by developed countries such as USA, China and European countries which led by United Kingdom, Germany and France.

Table 6: *Service imports (BoP, current million US$)*

	1995	**2015**
United States	141,410.00	488,651.00
China	25,222.82	468,895.94
Germany	133,166.23	299,090.32
France	74,553.38	231,731.62
United Kingdom	65,676.59	213,964.75
Central Europe and the Baltics	25,139.01	111,353.47
Euro area	454,194.16	1,328,101.55
European Union	565,147.37	1,748,122.05
Romania	1,832.00	10,926.96
World	1,330,864.19	4,712,526.60

Source: *World Bank*

Therefore, the statistic data reveal the growing importance of services in national economies and international trade. The main reason (Lemon, 2006) is an increase in the production of intermediate services (i.e. outsourcing).

Foreign direct investment and services

The initial motivation of FDI was the search for resources. Large international companies had set up subsidiaries and branches in poorly developed countries which have significant natural resources. Over time, the transnational companies have developed FDI, motivating them to move to new markets and improve efficiency. Thus, in the FDI typology, additional types of investment (market - seeking investment and efficiency - seeking investment) (Matei, 2004; Iacovoiu, 2009; Haralambie, 2015) appeared beside resource-seeking investment.

Along with the increase in the share of services in GDP, more and more specialists noted the predominant orientation of FDI towards the tertiary sector (Matei, 2004; Iacovoiu et al., 2009, Riedl, 2010; Bijsterbosch, Kolasa, 2010; Bhattacharya, 2012). This also involves changing the focus of transnational companies on certain determinants of FDI.

In the case of FDI, in the services sector, foreign companies are interested in the size of the domestic market, the possibility of accessing regional markets, which is favored by existing free trade area or customs unions, but also by the potential of increasing the local / regional market.

In addition, the existence of FDI services in a host country can attract and perhaps stimulate innovation by manufacturing firms (Fernandes & Paunov, 2012), thus becoming an asset in attracting future FDI. The researches and analyzes revealed other determinants for FDI in the tertiary sector. Thus, Ramasamy & Yeung, 2010 demonstrated that "manufacturing FDI is the single most important determinant of FDI services." Thus, transnational service companies adopt a strategy of customer follow-up - home-producing firms. Therefore, they will serve the same manufacturing companies as in the home country. The location and relocation of the subsidiaries of transnational service companies are related to the presence of companies manufacturing in various markets, given that services are often non-tradable. Therefore, we can talk about interdependence and complementarity between manufacturing and the FDI services (Nefussi, & Schwellnus, 2010). In addition, the existence of FDI services in a host country can attract and perhaps stimulate innovation by manufacturing firms (Fernandes & Paunov, 2012), thus becoming an asset in attracting future FDI.

The presence of foreign capital in different financial banking systems is explained by different specialists (Botrić, 2010, Matei & Done, 2009) through the medium of the existence of clients who have accustomed in their home countries. In view of the intensive nature of labor in the service sector, a determinant factor is the quality of the workforce (Ramasamy & Yeung, 2010; Kinda, 2010), therefore the education and long life learning become imported instruments for public authorities, which can thus help attract FDI in the tertiary sector.

The importance of services as a sector for FDI was the United Nation Conference on Trade and Development`s officials also noted who dedicated the 2004 World Investment Report to this issue.

The figures published by UNCTAD show a sustained increase in FDI in the tertiary sector from 25% in the early 1970s to about 50% in 1990 and about 60% in 2002 (UNCTAD, 2004). In 2014, according to UNCTAD data from the World Investment Report 2016, the FDI universe is dominated by a service sector accounting for 64% of the global FDI stock (manufacturing represents 27%, the primary sector, 7% and 2% is unspecified). Weights recorded in developing Asia and transition economies (70%) are higher than the world-wide average.

Structural changes to the FDI sector in the tertiary sector have also been observed worldwide. By the 1990s, the main subsectors which were targeted by foreign investors were trade and finance, but after 2000, their focus was on sectors such as electricity, telecommunications, water supply and business services - ranging from real estate to professional services and IT-enabled Corporate services (UNCTAD, 2004).

Significant changes are also noted with regard to the countries of origin for FDI in the tertiary sector. If by the end of the last century, foreign stock of FDI services were dominated by US firms, after 2000, new competitors emerged on this market, coming from the EU and Japan.

The concentration of FDI in the tertiary sector worldwide can be explained (Ramasamy & Yeung, 2010) by taking into account the following considerations:

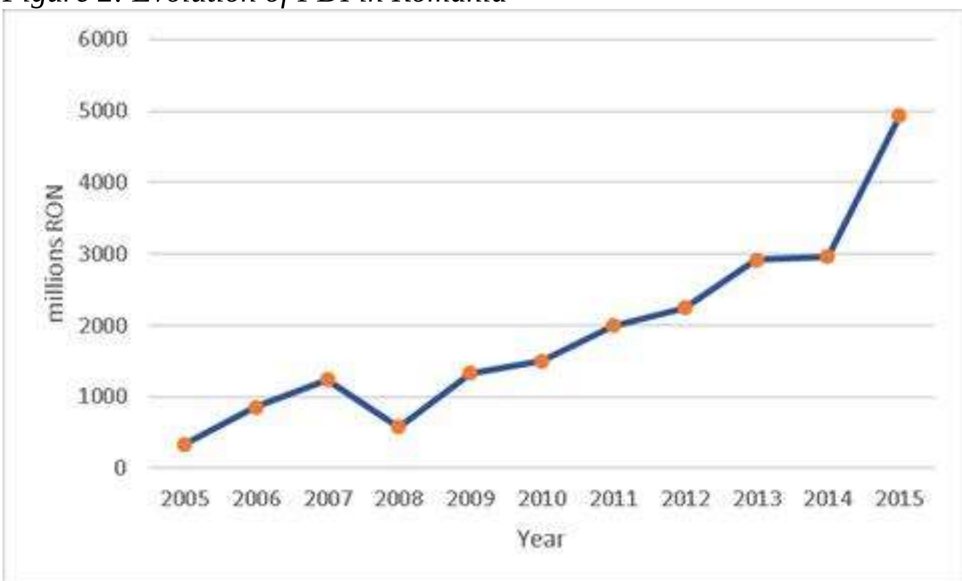
- Increasing the importance of the services sector in the national economies and the world economy;
- Certain services are being non-tradable, the only possibility to access foreign markets is FDI and not trade in services
- Privatization of public utilities which has allowed foreign investors with the necessary financial strength and expertise in the field who have enjoyed the liberalization of these economic sectors;
- Most FDI were implemented by taking over local businesses, mergers and acquisitions being the main way to achieve FDI in host countries;

- growing importance of off-shoring and/or outsourcing of services generated by technological progress that determine the tradability of the information based services (some services are offshored to foreign affiliate or outsourced to service providers from host countries).

Foreign direct investment in Romanian economy
The role of services sector

Romania has a marginal position in the region in attracting FDI. Even though public authorities have started the process of privatizing the large companies from the industry and services, the FDI flows which are received by the Romanian economy have modest values compared to other countries in the region. None of the EU membership has had spectacular effects on FDI attracted from or outside the European Union. Factors such as political instability, taxes' instability and lack of infrastructure had a greater share in our country's assessment as a potential country for transnational companies over other determinants such as workforce training or low wage levels. After 2000, there is also a predominant concentration of FDI in services in Romania's case:

Figure 2: Evolution of FDI in Romania



Source: *Authors own from National Institute of Statistics*

As it can be observed, in the analyzed period, the FDI in Romania have seen a sharp increase. In 2005, FDI was mainly located in the tertiary sector, manufacturing accounting for 37.3% of the total. From the service category, the most important subdomains were:

- retail and wholesale trade (15.0%),
- financial intermediation and insurance, (14.5%)
- telecommunications (10.9%).

After ten years, in 2015, the service sector attracted the largest share of FDI, and manufacturing holds 31.8 % of the total FDI balance. Of the category of services, the most attractive for foreign investors were:

- financial intermediation and insurance (13.1%),
- trade, (12.2%);
- construction and real estate transactions, (12.2%);
- professional, scientific, technical and administrative activities and support services (6.3%).

Thus, in Romania, foreign investors also are distinguishable in the tertiary sector, but the stock of foreign capital in services is less intense than that recorded at the international level. And in the case of Romania, there is an increase in the importance of the service sector and, moreover, there is a strong potential for intensive labor services (derived from the abundance of labor force and the relatively low cost of this production factor) and professional and business services (such as IT, engineering, architecture, and technical consultancy services).

The main sub-domain targeted by FDI in the services sector is the financial intermediary, as the Romanian financial sector is dominated by foreign companies (Matei & Done, 2008; Dracea, Cristea, 2008). At the end of 2015, the Romanian banking sector included 36 credit institutions, out of which 7 branches of foreign banks. Banks with foreign capital accounted for about 91 percent of assets` banking sector (NBR, 2016). The takeover of the foreign sector's banking sector was gradually achieved, after 1990, mainly through mergers and acquisitions, including the privatization process. The most important banks with majority state capital – Romanian Commercial Bank, Romanian Bank for Development, Agricola Bank, Agricola Bank and Banc Post were privatized, the majority stocks being bought by EU banks. There were also foreign banks that preferred a different way of implantation, namely green field investment. Following the wave of privatizations of the most important banks in Romania, merging and acquisitions took place between banks with private or foreign capital, which led to the reduction of the number of credit institutions (such as the merging between Tiriac Bank and Unicredit Bank).

Table 7: *The presence of foreign capital in Romanian banking system*

	2014	**2015**
Credit institutions, Romanian legal persons, out of which:	31	31
Credit institutions with full or majority state capital	2	2
Credit institutions with majority private capital, of which:	29	27
With majority domestic capital	4	4
With majority foreign capital	25	23
Branches of credit institutions, foreign legal entities	9	7
Total credit institutions	40	36

Source: *NBR Annual report, 2015*

At the end of 2015, foreign banks held about 90% of the net aggregate asset, the largest share in net assets being held by Austrian banks (33.3%), French (13.5%) and Greek (10.6%). The foreign banks that are operating in Romania initially focused their activity on multinational companies, their presence in our country being based on the client's follow-up strategy. Subsequently, the local economic agents and the population were also targeted to increase the market share, the trend being to expand retail activity.

Prior to 2008, there was an increase in lending activity in Romania, which was also supported by external financing from foreign parent banks, as local sources of funding were exceeded. After the crisis, foreign banks supported the capitalization of the Romanian banking system, assuming commitments under the Vienna Initiative (EC, 2015). Thus, Erste Group Bank, Unicredit Group, Raiffeisen International, Volksbank, Société Générale, Piraeus Bank, Alpha Bank, National Bank of Greece and EFG Eurobank have committed themselves to maintaining their exposure to Romania by providing financial support to subsidiaries The financial crisis has also led to a change in banks 'behavior towards customers, in the sense that it pays special attention to improving consumers' financial culture/education as a component of consumer protection.

Moreover, given the low financial inclusion specific to Romania, banks are also trying to attract disadvantaged categories into the banking system by offering specific services, but also by launching financial education programs so that these people understand the characteristics and risks of finanicial products. The Swiss franc crisis, which also manifested in Romania, has shown that many banks` customers have obtained foreign currency loans but have not been aware of the importance of currency risk and the posibility of its occurrence during the course of the credit.

Specialists note the positive impact of foreign banks on the economy of host countries, with contributions to domestic competition, increase of access to financial services, enhance financial and economic performance of their borrowers, and improvement of financial stability. The international financial crisis has also reveal the negative aspects of the involvement of foreign banks (Matei & Done, 2009; Claessens & Horen, 2014) such as reducing lending compared to domestic banks or promoting "cherry pick" policy (the foreign banks select only clients with Stable financial situation, leaving local banks with weak customers, so an increase in local bank's risks is possible).

Another services` sector dominated by FDI is commerce. In spite of the large number of companies operating in retail trade, this sector is dominated by large foreign network stores: Metro Cash & Carry, Selgros Cash & Carry, Carrefour, Billa, Mega Image, Profi, and XXL.

Despite the touristic potential of our country, the presence of foreign investors is modest (Ungureanu & Nastić; Ungureanu 2016). Explanations would be the lack of an adequate transport infrastructure, tourism-specific infrastructure (superior accommodation) and qualified staff. Foreign hotel chains (such as Ibis, Ramada) have concentrated their businesses in major cities, with an uneven geographic distribution of accommodation structures and their lack from the major spa and mountain resorts in Romania. A services' sector with a great increase of the value added and financed by foreign investments is the sector of IT&C services'. Romania has a highly skilled labor force for the IT & C domain. This aspect combined with the relative low level of the salary make the Romanian IT&C sector highly attractive for foreign investors.

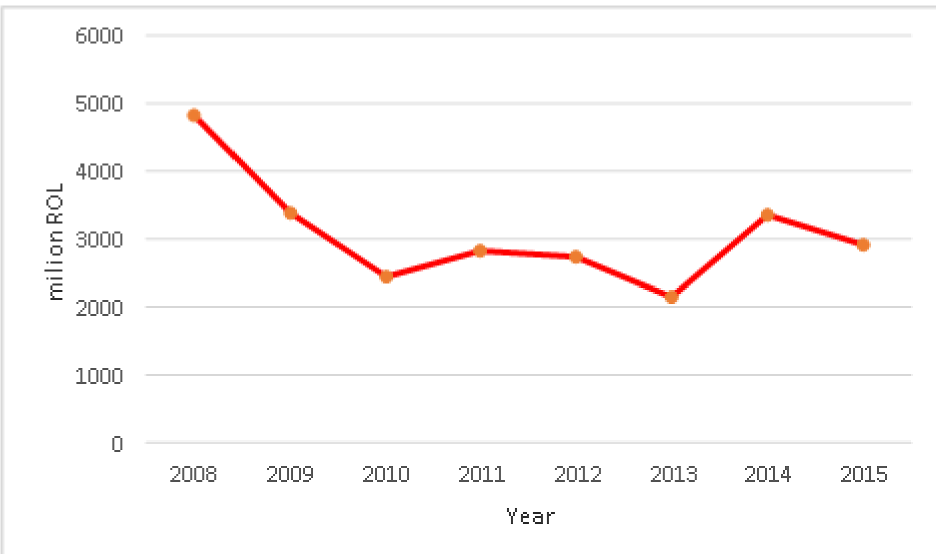
The Romanian IT&C sector has developed on the basis of four business models:

1. Big Romanian company, with strong connections in the political environment; these companies have virtually captured the whole market for developing software applications for administration.

2. Subsidiaries or local offices of foreign firms. These companies are Romanian firms and, generally, they have implemented only market activities and/or consulting services and technical support for local customers or for customers from entire world.
3. Small and medium companies that integrate software applications and provide technical advice and support to local customers or to a small number of customers from abroad.
4. Freelancers that are independents and work for multiple projects, usually from home and for foreign customers. They can offer both application development services as well as consulting and technical support services.

As it can be observed, the major activities of the IT&C companies are represented by services. This fact is common for majority IT&C business from the entire world because, after implementing a complex software application, the main effort is represented by configuring, integrating and maintaining this application to the customer site. In Romania, the investments in the field of IT&C has seen a downward trend between 2008 and 2010, followed by a relative stabilization between 2010 and 2013 and an upward trend for the period between 2013 and 2015.

Figure 3: *Evolution of investments in the IT&C field, in Romania*



Source: *Author own from National Institute for Statistics*

This behavior can be explained by the influence of 2008 crisis over the global economy and by finishing of the main government investments in IT&C field. At the moment of 2008 Romania has a good level of informatization of public administration. On the other hand, the necessary investment in the IT&C sector do not reach high levels.

Although it does not represent the main sector from the point of view of FDI volume the IT&C sector has a great potential for this type of investment based on the high level of technical knowledges acquired by the labor force in Romania.

Conclusions

The development of services and increasing their share of GDP is a long-lasting process that has been favored by the liberalization of international trade in services under GATS, the liberalization of trade in services within the European Union, and technical progress in the field of ITC. Given the complexity of this area, the low share of services in world trade compared to that of goods, the negotiations continue today, 23 members of the World Trade Organization (WTO) trying to sign a new agreement named Trade in Services Agreement (TiSA). The main objectives of this agreement are opening of markets and improving rules in areas such as licensing, financial services, telecoms, e-commerce, maritime transport, and professionals moving abroad temporarily to provide services.

Foreign investors have realized the potential of this sector and are concentrating their capital with preponderance in this area. This trend is also observed in the case of Romania, the most attractive subsector for FDI being financial intermediation.

For Romania the main interest in the field of FDI is represented both by the need to increase the number of industrial unit production and by the need to develop high added value sectors like IT&C.

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