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6. INWARD PROCESSING TRADE AND THE ROMANIAN FOREIGN TRADE

George GEORGESCU*

1. The International Dimension of IPT

The lesson of many developing countries, mainly from S-E Asia (lately the lesson of China) shows that, besides changes in trade flows, the Inward Processing Trade (IPT) has fostered the economic growth, inducing significant improvements in domestic and external performance. Given the particularly high ability of these countries to assimilate the technology and know-how transfer, IPT has made a major contribution to their successful development model.

On the other hand, the developed countries implemented specific policies for supporting companies which transferred abroad part of the processing operations (Outward Processing Trade - OPT). At the same time, conditions and restrictions have been introduced to regulate these operations (including quotas, origin rules and customs duties on external value-added), considered as better than total outsourcing, and at least partially protecting the domestic production.

It is worth mentioning that multinationals and Trans National Companies (TNC) themselves, as a response to increasing competitive pressures exerted by the developing countries, have adopted strategies for international fragmentation of the production chain. Mostly labor-intensive activities have been located in geographical areas with low wages. This century seems to show a new type of international business management, related to the opportunities for global comparative advantages. The TNC are creating across the world a system with functional components (material and technical supplies, R&D, production and sales) located in companies working in many countries, with a single command center. It is obvious that the world economy is changing rapidly and sharply, as OPT/IPT contribute to the vertical integration at the global level. Decreasing transport, communication and coordination costs, international trade liberalization, geographical proximity are completing the framework of global comparative advantages.

Following its international dimension and importance in the context of the world economy globalization, the OPT/IPT impact would have to change the economic

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¹ For instance, by the Special Access Program (1984), USA imposed a max. 25 percent of value-added incorporated in products assembled abroad.

Inward Processing Trade and the Romanian Foreign Trade

theory itself. Indeed, the main assumption of the Heckscher-Ohlin model and also of the international trade theory regarding the exports as an exclusive result of the combination of internal production factors, has proved to fail under the circumstances of significant increase in trade in intermediate goods, inducing changes in labor market: reducing demand for unskilled labor and increasing demand for skilled labor, thus creating wage inequality.

Further, we shall try to estimate the IPT in the case of Romania, according to available data and information.

2. Developments in Foreign Trade IPT Flows

The study of the Romanian foreign trade by customs regimes points out a strong increase in IPT flows (Appendix 1). Briefly, the exports, imports and incomes related to the IPT during 1999-2002 are shown in Table 1.

Table 1
USD mill.

	1999	2000	2001	2002
Exports after IPT	4531	5775.2	6755.3	7747.6
% in total exports	53.4	55.7	59.3	55.9
Imports for IPT	3318	4374.8	4728.2	5534.2
% in total imports	31.4	33.5	30.4	31.0
Incomes from IPT	1213	1400.4	2027.1	2213.4

These data and the Figure 1 show that the IPT value accounts for more than half of the total exports². The share of IPT in total exports increased from 53.4 percent in 1999 to almost 60 percent in 2001, decreasing to 55.6 percent in 2002. The difference between exports after IPT and imports for IPT (that is the income from IPT) has followed an increasing trend, from USD 1.2 billion in 1999, to USD 1.4 billion in 2000, to USD 2.0 billion in 2001 and to USD 2.2 billion in 2002. One could say that the data reveal a significant amount of the incomes from IPT, representing 3.4 percent of GDP in 1999 and around 5 percent of GDP in 2001 and 2002.

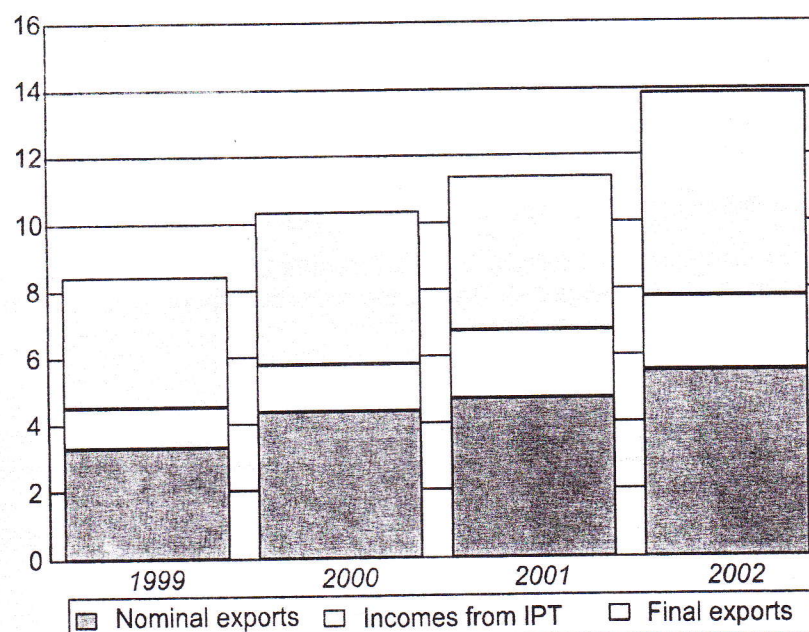
If we analyse the impact of the price index upon the exports amount we may see that it has been consistent enough and different as well, both in IPT and final exports series and in time series. Thus, the volume index of IPT has been decreasing in the last years of the considered period, as well as the value index. The final exports, after a slight increase in 2001, both in volume and value terms, registered a strong growth in 2002. The trend seems to be maintained also in 2003.

² Due to the insignificant value of OPT in the case of Romania (under 0.5 percent of the foreign trade), they were not the object of our study.

Figure 1

The structure of exports by customs regime during 1999-2002

Billion USD



Note: Nominal exports represent the value of imports for IPT, to which one adds the incomes from IPT to get exports after IPT

Table 2

- previous year = 100 -

	Total exports			Exports after IPT			Final exports		
	2000	2001	2002	2000	2001	2002	2000	2001	2002
Value index	122.1	109.8	121.8	127.5	117.0	114.7	116.9	100.9	132.5
Price index	98.7	99.2	106.3	93.0	101.6	109.1	107.1	95.8	103.0
Volume index	123.7	110.7	114.6	137.1	115.2	105.1	109.2	105.3	128.6

3. The Structure of IPT by Main CN Sections

In the past years IPT operations have had included mainly the temporary imports of materials for light industry processing (clothes and footwear). Later, such operations have expanded to other sectors, mainly in machinery and electronics (Appendices 2 and 3).

Although decreasing from 61.2 percent in 1999 to 58.7 percent in 2002, the main share in the structure of export goods after IPT by CN sections (EU Harmonized System), still is held by the light industry products. On the another hand, while in 1999 the share of machinery building industry products was 18.2 percent of the total

exports after IPT, it reached 24.5 percent in 2001 and almost 30 percent in 2002. In fact, almost all the increase of around USD 700 mill. registered by the total exports of machine building industry products in 2002 as compared with 2001 was due to the export rise in IPT flows. We should also stress that the share of IPT in the total exports of machine building industry products has increased from 57 percent in 1999 to 75 percent in 2002. A significant example is the development of assembling car cables under IPT regime, whose value increased from USD 80 mill. in 2001 to almost USD 400 mill. in 2002, holding the first place among the export products this year.

On the other hand, the final exports of Romanian products are still dominated to a large extent (more than 60 percent) by less complex products (metallurgical products, wood and wooden-articles, mineral products, raw chemicals, cement and other), while the share of highly complex products was decreasing from 22.5 percent in 1999 to 19.5 percent in 2002.

4. Geographical distribution of IPT

The data presented in Table 3 show that the growth in the total exports, exports after IPT and final exports was influenced by the IPT trade flows with EU countries. Out of the total of USD 7.7 billion of these flows in 2002 (Appendix 4), the EU countries absorbed 85 percent, i.e. USD 6.5 billion. The main countries which are operating with Romania in OPT/IPT regimes are: Italy, Germany, France, United Kingdom and the Netherlands, which hold more than 90 percent of the Romanian IPT exports toward EU.

Table 3

The share of exports after IPT in total exports

- percent -

	1999	2000	2001	2002
TOTAL,	53.4	55.7	59.3	55.9
of which:				
European Union	69.8	73.6	74.7	70.5
- Italy	76.7	79.0	79.0	72.7
- Germany	75.5	75.6	78.5	78.0
- France	67.5	75.9	78.4	69.2
- United Kingdom	78.7	80.8	82.1	85.3
- The Netherlands	55.5	58.1	58.7	65.6

As regards the light industry products, the largest share (83.6 percent in 2002) was registered by the IPT exports to Italy. As for the other countries, the share of machine building industry products ranged between 30 percent and 40 percent. It is worth underlying that, on the another hand, the final exports to EU market was low, which revealed also the high degree of Romanian exports' dependence on the external orders for IPT.

5. Economic Study of IPT: Advantages, Risks, Contribution to the Economic Growth, Perspectives and Policies

When generally discussing about IPT, we focus our attention upon advantages concerning employment. Many times we ignore other essential advantages such as: technology and know-how transfer, often accompanied by foreign investments, the rise in labor force skills, the increase in product competitiveness, the improvement of managerial capabilities, marketing included, the connection to the economy market quality and standards, the foreign exchange currency contribution to the diminution in trade and current account deficits and to the consolidation of the macroeconomic stabilization.

It is obvious that IPT has several disadvantages too, first of all the increase in external vulnerability and in the degree of exposure to the world market fluctuations. In our opinion they are relative, as their worsening depends exclusively on the way one can develop policies in order to set up a functional market economy, as well as on the extent to which knowledge assimilation could improve economic performance.

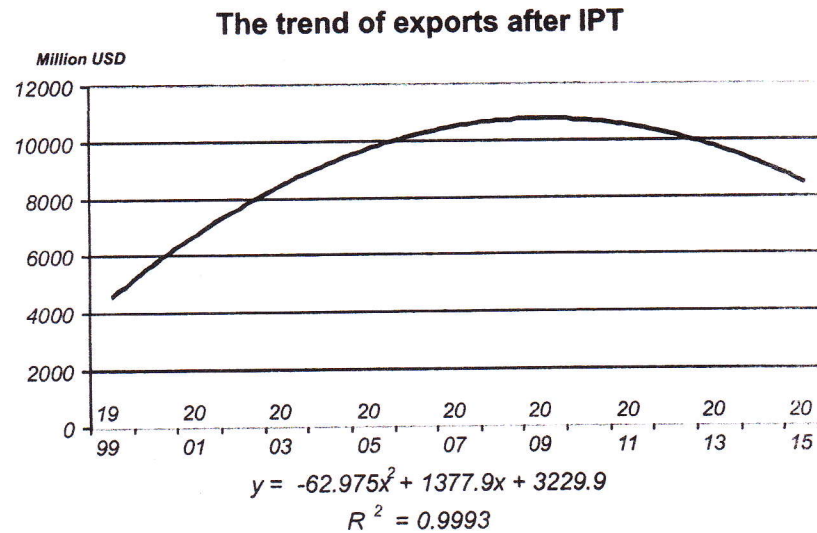
Essentially, in the absence of accurate evaluation tools of all advantages and disadvantages respectively, we may only assume that IPT fully complies with the recent trends in the economy and world trade development, having a prevalent positive impact in the case of Romania. In fact it represents a chance in the medium and long run.

Besides the direct impact upon the dimension and structure of exports, IPT has indirect positive effects on another important factor of economic growth, namely the investments. As it is well known, IPT implies a technology transfer too, in most of the cases being promoted by new companies with foreign capital, leading to the increase in investments and in the contribution to the economic growth.

The volatility of IPT, the change in the initial conditions that determined its expansion in Romania and the advancement of other competitive countries (Bulgaria, Ukraine, Russia and others) with higher comparative advantages than ours, represent factors that raised the risks of transferring these operations to other areas and of dramatically decreasing the Romanian export/import trade flows. If these would happen, serious consequences would appear, not only for the affected economic actors but also for the entire Romanian economy.

The study of exports after IPT evolution during 1999-2002, confirmed also by some data on 2003, leads to the conclusion that their growth rate has been slowing down. According to the econometric estimates based on the assumption of polynomial function type of IPT evolution (Figure 2), the preservation of the recent trend would lead to a maximum value of these exports in 2008, afterwards IPT switching to a downward pace. Indeed, this estimate would be in accordance with the predictable reduction in the Romanian comparative advantages, mainly concerning labor costs (which are expected to gradually increase, both due to a wage rise and to a real appreciation of the national currency - the Balassa-Samuelson effect), a process influenced to a large extent by the accession of Romania to the European Union.

Figure 2



Therefore, as long as we are convinced that IPT has certain short and medium term advantages, from which Romania can benefit in the long run, we believe that actions and specific policies should be considered. Some of them are:

- Adapting the information system and the statistical data to the requirements of accurate evaluations of IPT dimension and impact, both vertically, up to product and company level and horizontally, at the level of foreign trade, industrial output, foreign investments and balance of payments, which could allow for taking the most adequate measures to stimulate positive effects, to mitigate the negative ones and to manage the risks of expanding/diminishing the IPT magnitude.
- Introducing fiscal/non-fiscal incentives for the economic actors that are operating under IPT regime, in order to maintain comparative advantages, at least at the present level, mainly in the cases of the companies with foreign capital.
- Creating an IPT promoting system, which would allow for the attraction of more foreign investments, mainly in the advanced sectors, to increase the IPT value-added.
- Implementing a supporting strategy for the companies operating under IPT regime, in order to prepare them for the post-IPT period, namely to identify markets and customers for exporting similar products having their own brand/trademark.
- Starting an assistance program and introducing a specific customs regime for the Romanian companies operating abroad (or intending to do so) under Outward Processing Trade (OPT) regime.

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Appendices

Appendix 1

Exports and imports by customs regimes during 1999-2002

- USD mill -

	1999	2000	%	2001	%	2002	%
Total exports	8486.9	10366.5	122.1	11385.0	109.8	13868.8	121.8
of which:							
Final exports:	3895	4552.7	116.9	4595.6	100.9	6090.5	132.5
Exports after IPT	4531	5775.2	127.5	6755.3	117.0	7747.6	114.7
Exports for OPT	60.9	38.6	63.4	34.1	88.3	30.7	90.0
Total imports	10556.8	13054.5	123.7	15551.6	119.1	17856.7	114.8
of which:							
Final imports:	7012	8357.0	119.2	10464.4	125.2	12013.9	114.8
Imports for IPT	3318	4374.8	131.9	4728.2	108.1	5534.2	117.0
Financial leasing	172.7	304.6	176.4	334.4	109.8	294.7	88.1
Imports after OPT	54.1	18.1	33.5	24.6	135.9	13.9	56.5
IPT Indicators							
Share of IPT in total exports (%)	53.4	55.7	-	59.3	-	55.9	-
Share of IPT in total imports (%)	31.4	33.5	-	30.4	-	31.0	-
Incomes from IPT (exports-imports)	1213.0	1400.4	115.4	2027.1	144.8	2213.4	109.2
Exports/Imports	1.4	1.3	-	1.4	-	1.4	-

IPT - Inward Processing Trade.
OPT - Outward Processing Trade.

Appendix 2

The structure of exports after IPT during 1999-2002

CN Sections	1999		2000		2001		2002	
	USD mill.	%	USD mill.	%	USD mill.	%	USD mill.	%
Exports after IPT	4531	100.0	5775.2	100.0	6755.3	100.0	7747.6	100.0
- of which:							7747.6	
I Live animals and products	7.9	0.2	3.3	0.1	2.1	0.0	2.3	0.0
II Vegetable products	0.7	0.0	0.5	0.0	0.6	0.0	0.8	0.0
III Fats and oils	0.06	0.0	1.1	0.0	1.0	0.0	0.9	0.0
IV Food products	13.4	0.3	17.8	0.3	30.3	0.4	28.1	0.4
Total agri-food	22.1	0.5	22.7	0.4	34.0	0.5	32.1	0.4
V Mineral products	19.1	0.4	37.0	0.6	15.1	0.2	76.5	1.0
VI Chemical industry products	83.1	1.8	96.7	1.7	92.3	1.4	23.7	0.3
VII Plastics and articles	86.7	1.9	155.0	2.7	134.4	2.0	86.2	1.1
Total chemical products	169.8	3.7	251.7	4.4	226.7	3.4	109.9	1.4
IX Wood and articles	42.5	0.9	44.6	0.8	49.1	0.7	40.8	0.5
X Wood pulp, paper	10.9	0.2	19.2	0.3	22.4	0.3	21.7	0.3
Total wood products	53.4	1.2	63.8	1.1	71.5	1.1	62.5	0.8
VIII Hides, skins	42.8	0.9	59.6	1.0	97.9	1.4	125.5	1.6
XI Textiles and articles	2049.7	45.2	2375.1	41.1	2847.1	42.1	3296.1	42.5
XII Footwear, hats	658.7	14.5	771.0	13.4	955.6	14.1	1124.4	14.5
Total light industry	2751.2	60.7	3205.7	55.5	3900.6	57.7	4546.0	58.7
XIII Stone articles, cement	36.9	0.8	40.8	0.7	30.3	0.4	30.1	0.4
XV Metals and articles	363.7	8.0	473.2	8.2	435.3	6.4	268.5	3.5
XVI Machinery	547.0	12.1	1044.5	18.1	1247.4	18.5	1619.5	20.9
XVII Transport equipment	261.4	5.8	344.1	6.0	433.8	6.4	615.4	7.9
XVIII Optical goods	17.8	0.4	26.5	0.5	35.5	0.5	42.8	0.6
Total machine building	826.2	18.2	1415.1	24.5	1716.7	25.4	2277.7	29.4
XX Miscellaneous, including furniture	231.6	5.1	258.1	4.5	318.2	4.7	337.2	4.4
99 Other goods	19.8	0.4	7.2	0.1	6.9	0.1	7.1	0.1

The structure of imports for IPT during 1999-2002

CN Sections	1999		2000		2001		2002	
	USD mill.	%	USD mill.	%	USD mill.	%	USD mill.	%
Imports for IPT	3318	100.0	4374.8	100.0	4728.2	100.0	5534.2	100.0
of which:					4728.1		5534.0	
I Live animals and products	7.0	0.2	11.3	0.3	11.8	0.2	6.7	0.1
II Vegetable products	0.4	0.0	2.1	0.0	8.8	0.2	18.0	0.3
III Fats and oils	1.1	0.0	0.8	0.0	0.8	0.0	0.8	0.0
IV Food products	3.1	0.1	3.4	0.1	5.8	0.1	8.2	0.1
Total agri-food	11.6	0.3	17.6	0.4	27.2	0.6	33.7	0.6
V Mineral products	59.4	1.8	100.4	2.3	58.3	1.2	51.7	0.9
VI Chemical industry products	126.5	3.8	170.7	3.9	88.0	1.9	71.4	1.3
VII Plastics and articles	113.2	3.4	156.2	3.6	223.7	4.7	264.9	4.8
Total chemical products	239.7	7.2	326.9	7.5	311.7	6.6	336.3	6.1
IX Wood and articles	31.8	1.0	32.9	0.8	34.1	0.7	35.1	0.6
X Wood pulp, paper	42.2	1.3	53.6	1.2	76.7	1.6	90.3	1.6
Total wood products	74.0	2.2	86.5	2.0	110.8	2.3	125.4	2.3
VIII Hides, skins	284.2	8.6	342.0	7.8	480.5	10.2	574.2	10.4
XI Textiles and articles	1744.4	52.6	1916.5	43.8	2234.8	47.3	2570.5	46.4
XII Footwear, hats	149.6	4.5	174.8	4.0	206.9	4.4	227.1	4.1
Total light industry	2178.2	65.6	2433.3	55.6	2922.2	61.8	3371.8	60.9
XIII Stone articles, cement	8.5	0.3	11.0	0.3	12.5	0.3	11.2	0.2
XV Metals and articles	198.9	6.0	330.1	7.5	345.3	7.3	306.7	5.5
XVI Machinery	384.7	11.6	894.7	20.5	730.7	15.5	1036.5	18.7
XVII Transport equipment	37.9	1.1	56.9	1.3	73.0	1.5	109.3	2.0
XVIII Optical goods	13	0.4	22.8	0.5	27.4	0.6	26.6	0.5
Total machine building	435.6	13.1	974.4	22.3	831.1	17.6	1172.4	21.2
XX Miscellaneous, including furniture	82.3	2.5	91.1	2.1	106.9	2.3	121.9	2.2
99 Other goods	29.8	0.9	3.5	0.1	2.1	0.0	2.9	0.1

Appendix 4

Geographic distribution of IPT exports and imports during 1999-2002

- USD mill. -

	European Union				CEFTA				Other countries			
	1999	2000	2001	2002	1999	2000	2001	2002	1999	2000	2001	2002
Total exports	5562.3	6618.4	7720.1	9301.1	597.4	853.7	807.7	882.1	2327.3	2893.9	2857.2	3685.6
of which:												
Final exports:	1641.2	1729.7	1939.9	2735.2	419.3	577.8	518.6	597.5	1837.2	2245.2	2137.1	2757.8
Exports after IPT	3884.2	4868.6	5764.6	6553.0	173.8	270.4	286.6	282.9	470.07	636.1	704.2	911.7
Exports for OPT	36.9	20.1	15.6	12.9	4.2	5.4	2.5	1.7	19.889	12.4	16.0	16.1
Total imports	6405.1	7388.4	8918.4	10422.6	971.6	1201.7	1536.8	1771.3	3180.2	4464.9	5096.8	5662.8
of which:												
Final imports:	3468.2	3858.5	4814.2	5813.4	847.8	1050.3	1368.7	1560.2	2734.1	3448.2	4281.5	4640.3
Imports for IPT	2793.0	3289.8	3797.6	4347.3	103.7	133.4	154.4	195.7	412.8	951.6	776.2	991.2
Financial leasing	134.9	232.3	298.5	255.0	13.7	12.6	10.4	14.5	23.9	59.7	25.5	25.2
Imports after OPT	8.9	7.8	8.1	6.8	6.4	5.4	3.4	0.9	9.1	4.9	13.1	6.2
IPT Indicators												
Share of IPT in total exports (%)	69.8	73.6	74.7	70.5	29.1	31.7	35.5	32.1	20.2	22.0	24.6	24.7
Share of IPT in total imports (%)	43.6	44.5	42.6	41.7	10.7	11.1	10.0	11.0	13.0	21.3	15.2	17.5
Incomes from IPT (exports-imports)	1091.1	1578.8	1966.9	2205.7	70.1	137.1	132.2	87.2	57.3	-315.5	-72.0	-79.5
Exports/Imports	1.4	1.5	1.5	1.5	1.7	2.0	1.9	1.4	1.1	0.7	0.9	0.9

IPT = Inward Processing Trade.

OPT = Outward Processing Trade.