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# Romanian foreign trade after Brexit - impact, main challenges and limits

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**Abstract:** *The Romanian foreign trade has significantly changed after 1990. The privatization of state companies, the economic restructuring and the EU accession had impacted not only on the size and export diversity but also on the trade structure and the commerce routes inside and outside EU single market. The paper presents trade relation of Romania with the UK in the context of the single market and analyses the Brexit impact on the foreign trade, by type of capital (domestic vs ISD), of activity (inward processing) and product technology. We demonstrate the impact of Brexit on export performance by groups of companies' levels and some related consequences for national foreign trade model and economic performance. Romania constantly registered in the last decades a trade balance surplus with the UK and we examine the profile and peculiarities of the bilateral relations. Main conclusions are focused on export sustainability and competitiveness.*

**Keywords:** *Brexit; foreign trade; export map; export sustainability; FDI; high-tech products.*

**JEL Classification:** *F10; F13; F21; F43; O24; N47.*

## 1. Introduction

Trade offers opportunities that raise the overall output through: specialization in industries with comparative advantages (Ohlin, 1933), driven by technological differences and/or the patterns of production factor abundance and increasing company size and productivity (Melitz, 2003)); fewer trade barriers, which supports competition at

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micro-level among firms, leading to lower prices for export (Krugman, 1979). Greater integration facilitates knowledge transfer at lower costs and contributes to productivity and profitability increase. (Bustos, 2011; Grossman & Helpman, 1991; Zaman G. Vasile V., 2013);

Other economists (Zaman, G., Vasile, V., Cristea, A., 2012), when dealing with foreign direct investments (FDI) and their importance for an economy, mentioned that a change in direction of FDI from the "non-tradable" to the "tradable" sector contributes on long term to a better integration of an economy into international value chains, to the settlement of infrastructure shortcomings, as well as to improved human capital expertise.

One particular aspect of FDI companies in Romania consists in their main orientation towards the low-tech sectors and medium-low tech industries (Vasile, V., Zaman, G., 2012). Another important aspect to be highlighted on regards the FDI companies is their great importance for export of goods, especially after Romania's accession to the EU (Zaman, G., Vasile, V., 2012; Vasile, V., Bănică, E., 2016)

Market performance of companies is valued, among others, by export dimensions, production factors efficiency and ownership. FDI, labour productivity and export of the high-tech goods are the main factors for enhancing a performant business model in emerging countries (Bănică, E., Vasile, V., 2017).

Specialists consider trade important both as quantitative (Harrison & Rodriguez-Clare, 2010; Zaman, G., Vasile, V., 2016) and as qualitative global effect *i.e.* on income increase (Feyrer 2009) or wealth. Moreover, Brexit will reduce economic integration (Dhingra S., Ottaviano G., Rappoport V., Sampson T., Thomas C., 2017) in Europe. Lower trade due to Brexit is likely to cost both the Romanian and the UK economies, regardless the long-term benefits from structural trade changes based on comparative advantages rather than lower consumer prices (which is related to the Brexit alternative – hard or soft). Many economic analyses and forecasts published after the referendum in the UK (2016) have been strongly debated. Brexit will have effects everywhere (Dhingra, Gianmarco Ottaviano, Thomas Sampson T., Van Reenen J, 2016). Some economic forecasts anticipated a negative impact on short and long terms in case the UK was to leave the EU (Dhingra *et al.*, 2016; Kierzenkowski *et al.*, 2016; IMF, 2016). Others proved to be just false alarms like the forecast from the HM Treasury (HM Treasury, 2016) which predicted a recession in case of a favourable vote to leave the EU (Tapsfield and Dathan, 2016). Nevertheless, one prediction came true: sterling pound fell to a 30-year low after the 2016 vote. On the other side, there are experts, which express an optimistic view of Brexit, from the UK point of view. Some support the idea that Brexit will lead to a strengthening of competition and growth, while slowing

down inflation (Minford, 2017). Anyway, the main reasons of the decisive vote of the UK citizens for Brexit were the EU long economic stagnation in last decades and the increasing migrant workers flows to the UK, putting pressure on labour market.

According to a study of the European Parliament on the Brexit impact on EU27, losses on both sides are expected (EU-IMCO Committee, 2017). All studies agree that the losses will considerably be larger for the UK than for the EU27. Only in very pessimistic scenarios the losses for the EU27 reach a significant size. The study found out that the trade linkages between the EU27 and the UK are of a similar intensity as trade between the EU and the US.

Brexit is expected to impact on the EU27 countries through different channels and magnitudes, such as international influence, to a largely uniform extent. For others the impact will vary depending on connectedness with the UK, in alignment with UK policy objectives, or showing vulnerability to shocks. Global Counsel Analysis (2015) placed Romania among the countries most protected by such shock waves, besides Italy, Croatia and Slovenia. Moreover, the Netherlands, Ireland and Cyprus hold an opposite position. The intra-EU trade of goods of the UK is mainly concentrated on Member States located in the northern and western parts of the EU. Those partner countries have an important growth rate in UK's total trade, based on high technology goods. The first five EU partners of the UK, Germany, France, the Netherlands, Ireland and Belgium, account for 32.8% UK's exports and 22.2% of intra-EU imports. Similarly, to many economies, the neighbouring countries play an important role in foreign trade transactions. The UK's external trade structure is balanced from the point of view of intra-EU and extra-EU geographic distribution. In 2016, the UK's intra-EU trade accounted for 47.5% of total exports and 49.5% of the UK's total imports, with a relative stable trend after the 2009 economic crisis. Prior to the crisis, the UK's foreign trade was more open to the European single market, but it did not exceed 62.7% for import and 56.3% for exports, the highest shares being achieved in 2006 (considering 1991-2016 as reference period).

Romania hold a modest position in the list of trading partners of the UK. The place in the UK's exports was almost the same during the 2000-2016 period, but on the UK's imports from Romania side there was an improvement in the exchange of goods and definitely an increase of trade of services.

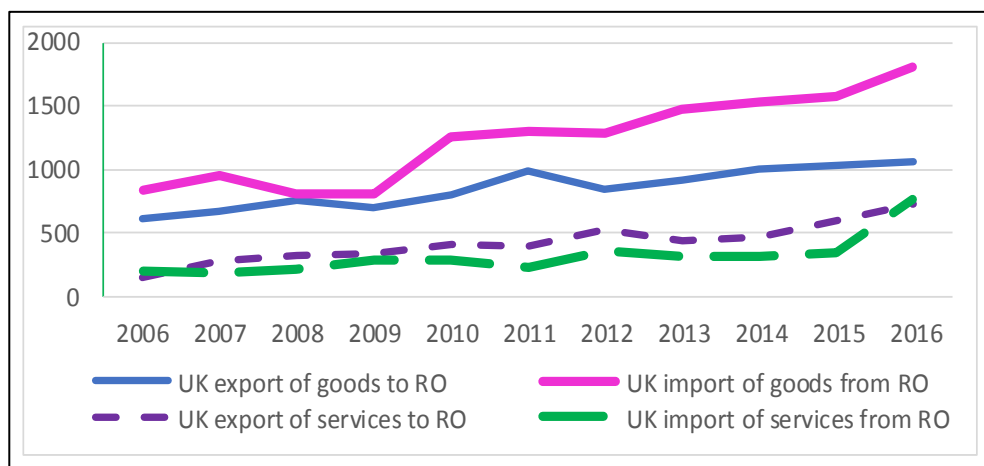
Out of EU27, 23-member states registered in 2016 a positive balance of trade of goods and services with the UK (except for Malta, Denmark, Sweden and Ireland) and Romania ranked the 14-th, with around £0.5 billion less than the first one, Germany, with £26 billion (ONS, 2017).

In 2016 Romania was the 41<sup>st</sup> UK partner in export of goods and 49<sup>th</sup> in export of services, registering a better position (up one rank in the case of goods and up three ranks in export of services) compared to the year 2015. As for imports we may mention a better position, *i.e.* the 39<sup>th</sup> partner for goods (up 2 ranks comparing to 2015 record) and much better for imports of services, the 34<sup>th</sup> (comparing to rank 52 in 2015) (ONS, 2017).

According to UK statistics, in 10 years (2006-2016) the UK total trade with Romania increased 2.4 times for export and 2.5 times for import, with the balance deficit growing almost 2.8 times, to £778 billion.

The share of the UK's export to Romania in total UK's intra-EU export reached 0.76% in 2016 and only 0.33% in its total export (intra-EU + extra-EU) while on the import side the registered shares were 0.69% and 0.43%, respectively.

**Figure 1. UK's trade with Romania, 2006-2016 (£ billion)**



Source: ONS 2017 – Statistical bulletin, UK Balance of Payments, The Pink Book: Office for National Statistics

From a 80/20 ratio between UK's export and import to/from Romania (goods and services) in 2006, it become 60/40 after 10 years, with a negative balance for goods and mainly positive for services (except the extreme years of the period).

In this paper we present a detailed analysis of the trade with bilateral goods between Romania and the UK, identifying the foreign trade activity of the companies, by type of

capital (domestic vs FDI), of activity (inward processing) and product technology. It will highlight the impact of Brexit on the export performance by group of companies and some related consequences for the national foreign trade model and, to a smaller extent, on economic performance.

As for the trade of services, we mention only the increase in the last years (2012-2016) for the import of services from Romania, especially due to the lower costs and the relative stagnation of the value of the export of services.

**Table 1. Trade balance in services, UK-Romania, 2012-2016**

	2012	2013	2014	2015	2016	2012	2013	2014	2015	2016
	£ million					Share in UK's intra-EU (%)				
Total International Trade of Services (excluding travel, transport and banking)										
UK exports to RO	211	242	223	230	273	0.58	0.59	0.52	0.52	0.51
UK imports from RO	94	125	153	142	217	0.46	0.51	0.62	0.55	0.70
Trade balance	117	117	69	87	56					
Technical, trade-related, operational leasing & other business services										
UK exports to RO	30	22	26	28	16	1.29	0.47	0.56	0.52	0.30
UK imports from RO	10	11	13	12	12	0.49	0.43	0.44	0.46	0.37
Trade balance	21	11	13	16	4					
Professional, management consulting & R&D services										
UK exports to RO	44	58	36	48	64	0.50	0.52	0.31	0.38	0.39
UK imports from RO	46	49	40	49	68	0.82	0.70	0.60	0.66	0.73
Trade balance	-2	9	-4	-2	-5					
Merchanting, Other Trade-related and Services between related enterprises										
UK exports to RO	18	20	7	8	13	0.21	0.32	0.12	0.12	0.17
UK imports from RO	9	9	14	12	24	0.20	0.19	0.31	0.26	0.47
Trade balance	9	11	-7	-4	-11					

Note: export = UK's export of services to Romania; import = UK's import of services from Romania

Source: UK Office for National Statistics

Total International Trade of Services of the UK in relation with Romania (excluding travel, transport and banking) was (2012-2016) around 0.5% of UK's intra-EU exports in the last 5 years, and increased the share in its intra-EU imports up to 0.7%.

## 2. Main coordinates of Romania's foreign trade after 1989

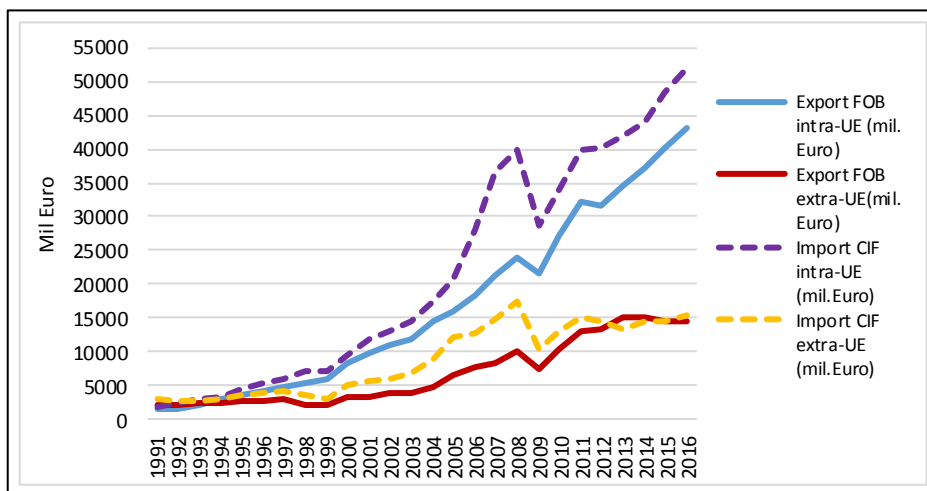
### 2.1. Trade spatiality on external markets

The Romanian external trade has an asymmetric territorial distribution, being mainly oriented to the EU single market after the accession to the EU in 2007. The situation

was different in 1990, when exports to the current EU countries accounted for only 45% of the total national exports. The intra-EU share has grown steadily over the last 26 years, reaching over 75% in 2016. At an annual average growth rate of 113%, the intra-EU export of goods contributes by over 25% to increasing gross domestic product, as compared to 10% in 1990. Imports of goods from the EU27 Member States also followed the export pattern, their share in the total national imports increasing from 36.1% in 1990 to 77.1% in 2016. Showing a similar annual average growth rate, imports of goods contribute by 29% to the gross domestic product, as compared to 13% as in 1990.

The coverage of exports by imports increased for the intra-EU trade from 79.1% in 1990 to 86.5% in 2016, with a peak in 1994, of 97.3%. After the economic and financial crisis, this indicator registered a relative stability, varying slightly between 82.2% and 88.2%. The degree of openness, calculated as a ratio of the sum of total imports and exports, in relation to the EU market, to the GDP, has steadily increased from 24.0% in 1990 to a maximum of 54.8% in 2016.

**Figure 2. Romania's intra-EU and extra-EU trade of goods, 1991-2016**



Source: NIS, TEMPO online database, <http://statistici.inse.ro/shop/>, Eurostat Comext database

Along with the development of economic relations with the European countries, Romania's trade with states from the extra-EU territory saw a reduction, by over 50%, as a share in the total exports and imports. In 1990, the trade with non-European countries accounted for 54.6% of the total exports and 63.9% of total imports, while in

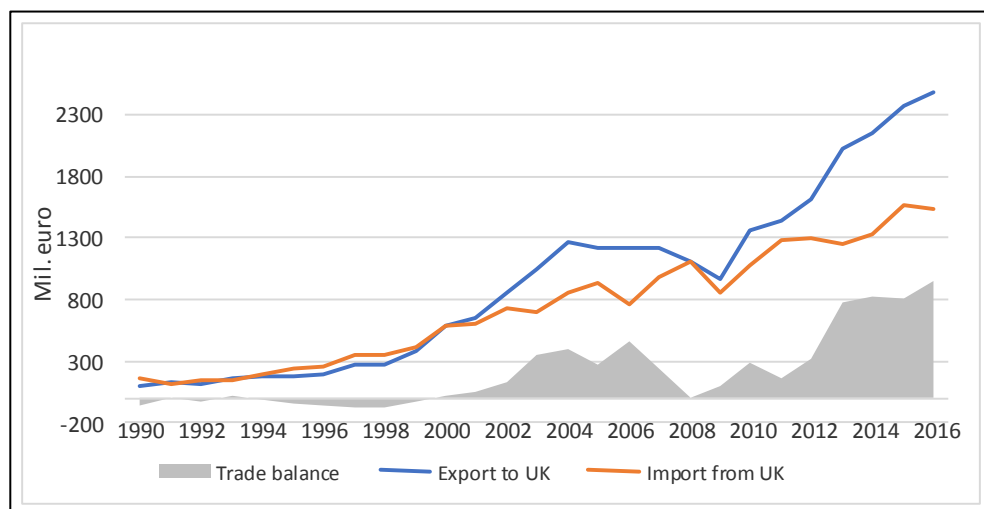
2016 the share of extra-EU trade of Romania's total external trade was reduced by more than a half, *i.e.* only 25% for exports and 23% for imports. However, the coverage of extra-EU exports by imports from the same geographical area increased from 53.6% in 1990 to 97.0% in 2016. It is worth mentioning that between 2013 and 2015, the trade balance of the extra-EU trade balance of Romania was positive, but the extra-EU trade net flows could not compensate for the commercial deficit in intra-EU trade. Thus, the openness to extra-EU trade constantly decreased, reaching only 17.1% in 2016. At an average growth rate in the last 26 years of only 108.6% and with such a reduced share in total national export, the extra-EU exports are not able to support the national economy in terms of competitiveness and sustainability.

## 2.2. Traditional external trade relations with the UK

Data analyses on Romania's trade volume made by partner countries proved that, from the point of view of the intra-EU exports, there are five traditional markets; for over 20 years, about 50% of exports are distributed to Germany, Italy, France, Hungary and the United Kingdom.

Export to UK increased after 2000 and could be considered as a positive signal of the goods competitiveness on the UK's market, mainly in the context of decreasing share of the intra-EU imports in the UK in the last years.

**Figure 3. Romania's foreign trade with UK, 1990-2016**



Source: NIS, Tempo Online database; Eurostat Comext database

Romania and UK have long bilateral trade relations; over the past 26 years, UK has been on Romania's top 10 export partners. The most intense trade relations were recorded between 2001 and 2003, when the UK was the fourth partner country for Romania's exports. At an annual average growth rate of 113.7%, in 2016 Romania's exports to the UK accounted for 4.3% of total national exports, ranking the UK the 5th among Romania's export partner countries. In terms of imports from the UK, there was an annual average growth rate of 110.4% during 1990-2016; in 2016 in accounted for 2.3% of Romania's total imports. The UK was ranked among the top 10 partners for import until 2004, then the UK ranked the 14<sup>th</sup> and 16<sup>th</sup>. The exports and imports to/from UK are 5 times and 9 times, respectively, smaller than those recorded with Germany, one of the most important and strategic trading partner. In 2016, exports to Germany amounted to 12.4 billion euros, compared to 2.5 billion euros, as exports to the UK summed up, accounting for 21.5% of Romania's exports. In the case of imports of goods, the difference is even more pronounced, namely 13.9 billion euros from Germany and only 1.5 billion euros from the UK. It should be noted that the UK, besides France, are the only top 20 partners with surplus bilateral trade with Romania. The main products exported to the UK consist of wires, cables and other insulated electrical conductors, clothing, parts of motor vehicles, engine parts, rubber pneumatic new tires, medicines. The first 10 exporting goods cover 54% of the total exports to UK.

Romania imports from UK goods like electronic integrated circuits, automated data processing machines, drugs, synthetic yarns, cars. The first 10 types of imported products account about 70% of total imports from the UK and this share increased in recent years.

On average, the goods exported to the UK incorporating high technology account for 9% of total exports, with a decreasing share from 2006 to 2016. The share of high-tech imports from the UK is almost double, on an average (during the analysed period) 18% of Romania's total imports of goods from the UK.

### **3. Multidimensional analyse of the companies trading with the UK**

#### **3.1. Research methodology**

Our research is based on a comparative analysis of the companies' trade with the UK highlighting the business environment evolution and the impact of Brexit on bilateral trade relations.

For the present study, we use available information from the National Institute of Statistics, namely data extracted from the international trade of goods statistical

databases. The following statistical variables are considered: the export value, the import value, the trade balance, the type of capital invested in the companies, the number of employees and the total turnover. Statistical information on ownership (*i.e.* companies with Romanian capital, mixed capital and foreign capital) has been available since 2008, so the detailed analysis refers only to the 2008-2016 period, *i.e.* for 9 years. In addition, we considered: a) the available information on inward processing of goods (extracted from foreign trade statistical databases), b) information on the nature of each external trade transaction<sup>1</sup> and c) selected products *i.e.* high-tech ones<sup>2</sup>.

The information on foreign direct investment refers only to the direct FDI investment enterprise status, according to the methodology applied by the National Bank of Romania<sup>3</sup>.

A special extraction from the micro database enables us to analyse the external trade activity of the firms, classified according to the multiple criteria mentioned above.

### 3.2. Research results

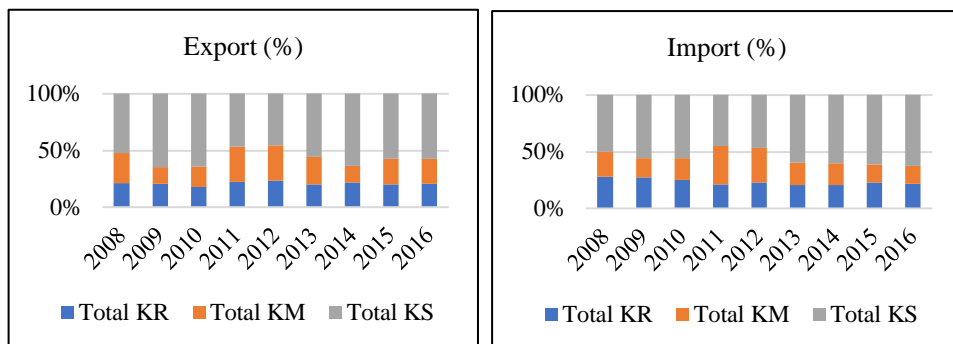
The analysis of the companies, by type of ownership, is based on the assumption that the foreign trade and especially the export as a current activity of the company for the output (goods) valorisation represent the prerequisite implying the technological level, economic performance and increased productivity, an important factor for ensuring the firm competitiveness. Romania's foreign trade activity in relation with the UK is carried out (over 50%) by foreign-owned companies.

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<sup>1</sup> The nature of the transaction means all the features that distinguish a transaction from another transaction, especially from the point of view of ownership transfer for the exported / imported goods, compensation for those goods, the purpose of the transaction, etc. There are distinct codes indicating the transactions of goods for inward/ active processing, (without the transfer of ownership to the processor) and the transactions of goods resulting from processing under inward system.

<sup>2</sup> The nomenclature used to identify high technology products is the one used by Eurostat in the dissemination of European Union data. This nomenclature defines trade of high technology products as the export and import of products under the SITC - Rev 4 (Standard International Trade Classification), according to the following categories: aerospace products; computers, electronics and telecommunications; pharmaceutical products; scientific instruments; chemical products; non-electric machines; armament. The list is based on the definition of the Organisation for Economic Co-operation and Development (OECD), according to which high technology products are those products requiring a high intensity of research and development.

<sup>3</sup> The direct foreign investment enterprise is a resident enterprise, legal person or not, where a non-resident investor has at least 10 percent of the voting rights or the subscribed share capital, *i.e.* the capital of the endowment / work capital of enterprises without legal personality (Branches). The holding of at least 10 percent of the votes or of the subscribed share capital, *i.e.* of the endowment / labour capital, is of prime importance in establishing the direct investment relationship.

**Figure 4 Romania's external trade with UK, by type of capital, 2008-2016**

Note: KR= Romanian capital; KM= mixt capital; KS= foreign capital

Source: Authors' calculations based on NIS data

As for the UK, in 2016, about 60% of exports and over 55% of imports were completed by foreign-owned firms, revealing a very strong dependence of Romania's foreign trade on foreign capital. In 2016 the share of companies with Romanian capital represented 20% of both total exports and imports and decreased during the analyse period only for imports. In the same time, imports from the UK performed by foreign firms increased by over 15 pp. The analytical data shows a high export volume dependency on the FDI firms from the UK and an increased number of companies oriented to export to the UK.

Thus, the number of companies in Romania having trade relations with the UK increased from 3165 in 2008 (3.5% of the total number of companies involved in external trade transactions in Romania), to over 5000 firms in 2016, representing 6.0% of the total number.

These thousands of companies engaged in trade relations with UK partners are primarily firms with domestic capital. Almost 60% of the number of firms undertaking trade transactions with UK between 2008 and 2016, were domestic companies (with Romanian capital), while foreign-owned companies accounted for 27% on average during the analysed period.

**Table 2. Number of companies in Romania trading goods with the UK, 2008-2016**

	Total number	KR		KM		KS	
		number	% of total	number	% of total	number	% of total
2008	3165	1710	54.03	622	19.65	735	23.22
2009	3293	1816	55.15	489	14.85	893	27.12
2010	3589	2063	57.48	571	15.91	909	25.33
2011	4101	2313	56.40	810	19.75	977	23.82
2012	4344	2463	56.70	767	17.66	1113	25.62
2013	4348	2425	55.77	739	17.00	1183	27.21
2014	4556	2544	55.84	771	16.92	1239	27.19
2015	4777	2688	56.27	785	16.43	1300	27.21
2016	5013	2900	57.85	784	15.64	1328	26.49

Note: The difference up to 100% represents the share of companies on which there is no information available in the consulted statistical database on capital ownership

Note: KR = Romanian capital; KM = mixt capital; KS= foreign capital

Source: Authors' calculations based on NIS data.

The Romanian companies, although numerous, do not have the capacity to produce goods for export as foreign-owned do, as the latter enjoy a technology and innovation capacity in production, distribution chain, and so on.

**Table 3. Average size of companies (measured by average number of employees) involved in trade with the UK, by capital ownership**

	Total	KR	KM	KS
2008	261	175	470	308
2009	211	128	411	290
2010	197	114	385	279
2011	185	113	334	233
2012	184	108	322	255
2013	195	120	323	269
2014	188	107	341	259
2015	185	100	336	270
2016	189	98	350	292

Note: KR= Romanian capital; KM= mixt capital; KS= foreign capital

Source: Authors' calculations based on NIS data

According to the economic theory, to some extent, the export and import volumes are determined by several factors of which the company size is of average importance (excepting IT companies). The figures show two interesting trends in average company size:

- a) the mixt ownership (domestic and foreign) is associated with the largest companies, on average, up to 500 employees and those exclusively FDI with 250-300 employees. The firms with Romanian capital are medium size, on average with 180-260 employees.
- b) the average size for all types of companies is decreasing and that could be explained partially. The UK market for imported goods is, to some extent, segmented by the technological level of goods, taking into consideration that over 70% of export in high-tech goods to the UK from Romania is carried out by foreign-owned companies.

Another aspect to be pointed out as regards the trade with the UK is the analyse of specific activities of the companies involved in inward processing. To some point, active processing contributes to total export increase, but is more vulnerable on unusual economic events, *i.e.* the last financial crisis. The comparative advantage of this kind of business is based on lower production costs and especially on the lower labour cost. The other consumptions are mainly distributed through the value chain of the horizontal industry development based on the firm's network coordinated by the mother company. Therefore, the economic disturbance in the country of origin of the capital will have a more direct effect on short term, the firm being relocated in low cost economic areas (for labour force or even for raw materials). Such companies experienced a sharp decline between 2008, when they represented about 39% of the total export to the UK and almost 14% of total import from the UK, and 2016 (17.4% and 11.4%, respectively).

**Figure 5 - Romania's exports and imports of goods under inward processing system, in relation with UK**



Note: KR= Romanian capital; KM= mixt capital; KS= foreign capital

Source: Authors' calculations based on NIS data

Foreign companies performing this type of activity in Romania are gradually withdrawing, the main causes stemming from increasing costs of labour production factor (labour force) and raw materials bought on Romania market, which could alter the profitability rate at the company level. Thus, after Romania's accession to the EU, the cost advantages obtained by the companies producing goods in inward processing system at lower labour cost than in the country of origin decreased and some of the companies chose to relocate their inward processing activity in geographic areas where the lost opportunities in the Romanian market could be recovered or even be improved. Another reason for reducing the volume of exports and imports of the companies with inward processing activity is linked to the methodology of compiling external trade statistics. According to fiscal rules, for performing intra-EU trade transactions in Romania, companies from other EU countries have to be registered for fiscal purposes in Romania. The result of this fiscal provision consists in possible recording of these transactions as any final goods sale between two distinct European companies. Normally, according to international recommendations and European legislation in force, transactions under inward processing system are registered in statistics under special rules, being distinguished by the normal/classic export/import activity. Therefore, for a proper data registration, reporting companies must be aware of their legal statistical obligation as well as of the proper application of methodology in reporting. In the same time, the methods applied to produce official statistics have to consider the globalisation effects on external trade relations and with the higher complexity of international trade relations.

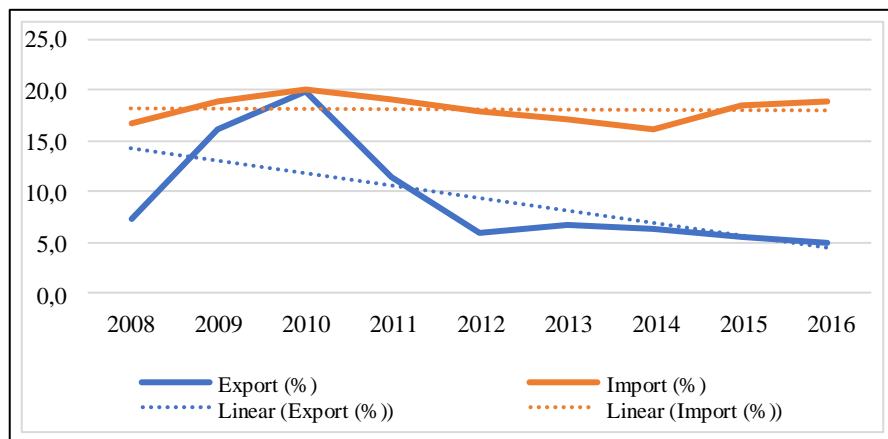
The export of goods from Romania to the UK consists of only 9% of high-tech goods (average value for the whole period, 2008-2016), while about 18% of imported goods from the UK contains high technology. Electrical equipment, products of the chemical industry, vehicles, pharmaceutical products are the most traded products in both flows, imports and exports.

The higher percentage of imports reveals the deficit in technology in the Romanian economy. Goods production without new and improved technology is less efficient than in countries which invest in research and /or acquire or create such technology.

Statistical data reveals a slight reduction in trade of high-tech goods in total foreign trade with the UK. It is worth mentioning that during crisis the export of high-tech products increased by 91% in 2009 and by 75% in 2010 as against previous year, while in 2012 the trade of such products was almost as in 2008. This explains why foreign-owned companies could rely on production of high-tech goods in Romania and their subsequent export to different countries, overcoming the negative effects of the crises in the country of origin. Since internal demand was seriously affected during the 2008-

2010 period by social and economic measures, the export of goods was even more stimulated.

**Figure 6. Share of high-tech goods in the total trade of Romania with the UK (%)**



Source: Authors' calculations based on NIS data.

The United Kingdom ranked the 12<sup>th</sup> among the top foreign investors in Romania (NBR data) holding a share of 2.4% of total FDI stock.

**Table 4. FDI stock in Romania with UK as a country of origin (end of the year)**

	2006	2008	2009	2010	2012	2014	2016
<b>TOTAL FDI stock (mil euro)</b>	16725	48798	49984	52585	59126	60198	70113
<b>of which, with UK</b>							
FDI stock (mil euro)	403	727	482	627	976	1509	1701
Share in total FDI stock (%)	2.4	1.5	1.0	1.2	1.7	2.5	2.4

Source: NBR, Foreign direct investment in Romania in 2016.

By the end of 2016, the structure by activity of the companies with subscribed capital from the UK was the following:

- extractive and processing industries: 47.29%;
- wholesale and retail trade: 19.67%;

- professional, administrative, scientific and technical activities: 11.81%;
- financial intermediation and insurance: 9.36%;
- real estate transactions: 5.64%;
- transportation, storage and communications: 2.24%;
- construction: 1.78%;
- agriculture, forestry and fishing: 1.28%.

Romania ranks the 4<sup>th</sup> in Europe among the countries with the largest number of new jobs created by foreign direct investment in 2016, according to the 2017 edition of the EY European Attractiveness Survey. In 2016 Romania attracted 132 foreign direct investment projects (up 32% over the previous year), which generated 17,545 new jobs.

The UK is on top of the list of investors in Europe, with over 43,000 new jobs created, followed by Poland (22,000) and Germany, with nearly 20,000 new jobs by FDI projects.

## **4. Some considerations regarding the Brexit impact on Romania's foreign trade**

### **4.1. The potential Brexit impact on Romania's trade performance and economic development**

The main outcome of data analyses could be summarised as following:

1. External trade of goods of Romania with the UK accounts for about 1% of the GDP, similar to Finland, Bulgaria, Italy, Slovenia, with a positive trade balance.
2. The sectoral distribution of trade is highly diversified, based on predominance of 'inter-sectoral' trade paradigm - importing technology and exporting commodities, based on pronounced differences in comparative advantage. The export of Romania to the UK is mainly represented by machinery and electrical equipment, textiles and garments, vehicles and transport equipment, plastics, rubber and metals. The import is relatively similar to the export structure, being represented by machinery and electrical equipment, textiles and garments, chemicals, vehicles and transport equipment, rubber and plastics (International Trade Yearbook of Romania, NIS 2017).

Using some expert's estimations and keeping in mind the history of bilateral trade relations between Romania and the UK, a summary on potential Brexit impact on Romania's trade performance and economic development has been made.

**Table 5. Summary on potential Brexit impact on Romania's trade performance and economic development**

Experts' assessment	UK-RO trade relation peculiarities	Expected Brexit impact on Romania's economy
CPB <sup>1</sup> experts show a reduction in the bilateral trade with EU (PWC 2016)	Relative autonomy and constant relations irrespective of Romania's status as a EU member state	No significant impact on bilateral trade relations - some historical bilateral relation will be preserved
Higher costs of trade	Export promoting environment: 1. 11 years of free trade in the Single Market + 2. The <i>Strategic Partnership</i> between Romania and the UK, launched in 2003, strengthened forward and expanded after Romania's accession to the EU in 2007 <sup>2</sup> .	Related to the post-Brexit EU-UK trade deal – “hard” or “soft” Brexit
FDI companies in Romania exporting to the UK	Low level in Romania's total export	Lower level on short and medium terms.
FDI from the UK to Romania - a discouraging impact on investment	FDI in RO from the UK is relatively low correlated with trade	Strategic uncertainty but expected negative impact
EU states imposing new regulations and other “non-tariff barriers”	Less important for the UK than for Romania, so it is expected to be avoided	Medium term for bilateral negotiation unless a common trade agreement at EU level, available for all EU member states is considered
Romania, Baltic countries and Finland - the least affected (EP, 2017)	Small share in total UK trade of goods and services	Relatively low impact on total trade balance, but a negative one
Trade balance	Romania's trade balance with the UK is positive for transactions of goods for over 15 years (except 2008, year of crisis)	-less positive impact for goods and higher negative impact for services
Brexit hard scenario and impact on trade partners' country (WTO option or FTA option)	-	Below 0.4% of the GDP (2030) Below 0.2% of the GDP per capita (2030)

Source: Authors' compilation.

<sup>1</sup> See <https://www.pwc.nl/nl/brexit/documents/pwc-brexit-monitor-trade.pdf>

<sup>2</sup> The high level of the RO-UK relations had been reconfirmed by the adoption of the 2011 Joint Statement on Enhancing the Strategic Partnership between Romania and the United Kingdom. By this document, the two countries committed themselves to work closely in order to promote economic growth in the EU, by:

- Driving forward the completion of the Single Market for services, the digital economy, energy and other fields, by eliminating barriers to growth;
- Promote free, fair and open trade between the EU and our major trading partners and working towards the conclusion of other Free Trade Agreements.

The two countries have agreed to act together to reduce barriers to business, promote the growing trade between RO and the UK, and support business links, especially in infrastructure, energy, tourism, and new technologies.

## 4.2. Does Romania have a national foreign trade model?

Until 1989, Romania followed a national pattern of foreign trade, benefitting from sustainable trade routes with countries of the former socialist bloc, plus China, America, the Arab states, even with few countries in the EU. External trade used to be characterised by specialization by the commercial routes.

Since 1990, Romania's foreign trade transactions have experienced a reorientation towards the EU, both in terms of import and export; in 2016 over 75% of trade transactions being performed with partners from EU member states. In the absence of a strong domestic industrial production, sustainable for export through domestic capital, these trade relations have only been made on a conjunctural basis, which over time have caused the fragility of the export activity.

Romania needs to redefine trade relations, moving towards a model that includes, as pillars, the following:

- national potential, for example agriculture or tourism, economic activities with a growth potential, which can contribute to sustainable export background building. These economic domains can generate specialized processing industries, associated to high value-added products, medium to high skilled job creation and local/regional development with active measures for social inclusiveness.
- the development of commercial relations based on the value chain of products/process, i.e. the integration of Romanian companies as satellites to the large manufacturing companies. Currently this happens to many domestic producers, their contribution being relatively low in added-value compared to the one of the big enterprises, mostly FDI companies. The system is related to the inward processing system, in this case the coordinators carrying out their activity in Romania but still benefiting from the low(er) labour cost advantages and of the cheap(er) national material resources.
- innovation; any structural model must be based on innovation on product and/or process level.
- Beyond the above pillars, the following should be considered as cross-cutting factors in defining a trade model:
  - regional trade agreements, mainly with the EU and EFTA;
  - bilateral trade agreements with certain countries where Romania has real potential for development;
  - Export diversification as an effect of innovation and change in consumption patterns.

In defining the pattern of trade, migration must also be considered. In countries where Romanian immigrants reside as multiannual European workers, by specific demand of Romanian goods they could initiate small entrepreneurship activities, which, also indirectly create a local demand for Romanian products (demanded by natives or other immigrants). Thus, the development of commercial routes and specialization by product groups specific to the country of origin occur, which means increased and diversified demand for Romanian products abroad. Therefore, homogeneous communities of migrants normally generate specific entrepreneurship, characterized by:

- products and services specific to their country of origin;
- temporal distribution of demand, dependent on the specific consumption patterns of migrant workers;
- allows for the development and adaptation of the host community's demand for products from the migrants' countries of origin.

Romanian foreign trade performance on the EU single market is rather limited by comparative disadvantages that continue to adjust our export with EU member states. So, the main coordinates for an improved national export strategy should consist of:

- Preserving trade relations by promoting traditional advantages;
- Reconsidering Romanian technological potential for diversifying export of goods and services, with a higher efficiency;
- Supporting domestic capital development for trade of high tech products through structural funds – based on technological transfer to businesses.

### **4.3. Possible effects of Brexit on the EU**

In the context of the negotiations with the EU, the UK might consider several important aspects:

- ensuring access to the European market, but this will depend on how the UK will approach the four European freedoms: the movement of people, goods, capital and services,
- regulating the situation of British citizens in the EU and EU citizens in the UK;
- There are two approaches when talking about consequences of Brexit on the EU's foreign trade:
  1. The UK could obtain a profitable agreement with the EU by maintaining the access to the European market (the so-called "Soft Brexit");

2. The UK will not maintain access to the EU market (the so-called "Hard Brexit"); Negotiations will be concluded without an agreement with the EU, so that UK's trade relations will be governed by the World Trade Organization regulations and other international treaties.

In its resolution of 5 April 2017 on negotiations with the UK following the notification that it intends to withdraw from the EU, the European Parliament clearly stated several aspects with impact on trade relations between the EU and component countries and the UK:

1. An agreement on a future relationship between the EU and the UK, as a third party, can only be concluded after the official withdrawal of the UK from the EU;
2. The future relationship must be balanced and comprehensive and should serve the interests of all citizens, from both the UK and the EU.

#### **4.4. The Brexit effects on the Romanian trade**

Some possible effects on Romania's foreign trade as well as the challenges in the near future are taken into consideration below:

1. One of the most obvious effects on the Romanian trade is the increasing cost of goods traded between Romania and the UK. There are two scenarios: a fall back to the WTO rules or a negotiated comprehensive free trade agreement (FTA). In the first case, it means supplementary costs for: tariffs and quotas, increased administrative burden (including customs formalities and VAT), trade-based fiscal regulation as well as the extent of non-tariff barriers to trade (*i.e.* health, safety and environment standards, rules of origin requirements etc). These costs will be transferred to consumers, so the price of goods will increase and so will the market competition, with a detrimental effect on domestic companies. In the second scenario, costs will imply: terms of access to specific sectors, including the standards and regulations for firms for conformity.
2. In either case, there is a need for a transitory regime, which will take several years and might generate an opportunity or new challenges for setting better bilateral trade regime.
3. The supply chains must be reconsidered or rebalanced, with additional effects on investments in the supply chain – relocation of some activities or logistic capabilities. The transaction cost of trade vs. service level cost will redesign the supply chain and the importance of specific nodes and relocation of some foreign companies with inward processing activity in Romania.
4. The trade relation of Romania with non-EU countries must be reconsidered as a counterbalance, which implies additional costs linked with (re)negotiation,

administrative and/or related to tariffs and quotas etc.; export expansion into new markets is a slow and costly process;

5. Along with the development of new economic relationships and new markets, relationships with older partners must be preserved and strengthened to reaffirm their competitive position on the global property market.
6. Transactions of goods will be treated as normal imports and exports between the UK and Romania. This may affect mainly Romanian importers of goods from the UK, as simplified VAT treatment would not be available anymore for them, but also Romanian exporters to the UK, if UK VAT would be charged upon import of goods to the UK. Transaction-level VAT treatment and hence invoicing and systems requirements would need to change. No EU reliefs will be available any more in the absence of the application of the EU legislation (such as triangulation relief, or simplified treatment for call-off works on movable goods, affecting mainly the inward processing industry in Romania with trading partners in the UK).
7. In the absence of continuing agreements, the cost of goods exported by Romanian companies to the UK may increase, thus making Romanian producers less likely to export products to the UK market, and similarly, the price of goods imported from the UK to Romania could increase, *i.e.* they become less competitive on the local market. Compliance costs and bureaucracy are also expected to increase significantly.
8. Both multinationals and Romanian businesses with operations in the UK may face significant costs, including tax charges, on a range of reorganization measures resulting from Brexit if it becomes necessary to relocate business as part of wider overall reorganization.

Other costs might also arise, such as costs of people relocating, setting up new offices (any new entity will require appropriate substance and suitably skilled local people to operate it).

In order to obtain the maximum out of Brexit for Romania, there are some limits which have to be overcome of:

- The need to deeply analyse the efficiency of Romanian exports as well as promotion policies and to create a crossword for reshaping the goods exports' structure, based on higher value-added products and promoting high-tech, including export of high-tech services;
- The political accountability regarding negotiations of agreements;
- Time frame limit and appropriate match of the negotiation period for maximum benefits from new bilateral trade agreement.

## 5. Some final considerations and policy recommendations

Based on the research developed in the present paper, some main conclusions and policy recommendations could be underline:

1. In the case of Romania, the intensity of trade with EU is higher, compared to non-EU area, with long lasting indirect effects, partially explained by Romania-UK bilateral relation analysis. So in order to mitigate the effects of possible unusual regional events, an intensified and more consolidated trade relation with non-EU countries could be considered, especially where Romania enjoys a higher potential as well as a geographic diversification of export routes. In this context, Romania needs to reconsider traditional trade relations with the former trade partners, *i.e.* Russia, China as well as South American countries.
2. The dependence of exports on foreign-owned companies is beneficial to the Romanian economy as long as Romania's economic area is of interest and part of the development strategy of those FDI companies. When this reality changes, either a reorientation of exports to new markets or a diversification of national supply to foreign markets will be necessary, which needs to stimulate domestic firms to create and produce sustainable goods on the domestic and international markets.
3. Romania's economic relations must not be so highly dependent on the EU market. Generally another balance in trade between intra and extra EU trade must be set, by groups of processing goods and services with higher value-added.
4. Trade volatility was and remains a main concern in the relation with EU area. Given the Brexit, stability needs to be ensured for the future by means of traditional trade networks like the one developed with the UK.
5. The impact of foreign trade with the UK on Romania's economic growth would probably be marginal after Brexit, but negative, given that the value-added brought by Romanian exports to Great Britain accounts for 4 % of the total.
6. The time for export of low price goods has passed, and Romania needs to reconsider the export competitiveness and repositioning on the external markets. Even in this "more favourable" marginal position of Romania, where Brexit is expected to impact on bilateral trade relation, the main concerns occur from the sectoral breakdown of the trade flows perspective, *i.e.* the inter-sectoral trade paradigm (pronounced differences in comparative advantage) with predominance of exporting commodities and importing technologies. It is unclear even on long term whether there will be some net positive benefits from Brexit for the Romanian economy. On short and medium terms, additional cost requires adjusting measures with potential negative impact, especially for Romanian capital firms with export activity. Additional trade

costs (in any scenario we consider) associated with risk for non-tariffs barriers will probably absorb the potential advantage of stimulating innovation transfer and productivity increase as adjustment response to preserving Romania's export position on the UK market.

We point out that **Brexit must serve as a catalyst for renewing the Romanian foreign trade strategy and policies** by enforcing a right balance between dependency on EU single market as a EU member and developing trade relations on medium and long terms with other countries, where Romania can have either an exceeding trade balance or comparative advantages based on high-tech exports.

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