

## LOHN'S CONTRACT

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### **Abstract**

*The Romanian term *lohn* regime is a derivative of the German word "Lohn" which means leaf. Lohn is a real and easy way to develop a business, consisting of an international collaboration based on a contract concluded between two companies from different countries, in which one performs custom works by processing raw materials, materials, according to certain models, designs and patterns that belong to the beneficiary company, which takes over the finished product in order to sell or capitalize on the market. Lohn processing operations give rise to legal relationships of collaboration in terms of production and technique that the manufacturer must follow. These operations involve an international economic cooperation, which we find under the name of labor exports, custom production or monopoly trade.*

**Key words:** trade, contract, producer, beneficiary, import, export

### **INTRODUCTION**

A contract is a civil legal act that consists of an agreement of will between two or more persons for the purpose of establishing, amending or terminating a legal relationship.<sup>1</sup>

The defining, characteristic, essential feature of a contract is the agreement of will of the parties expressed with the intention to be legally bound.<sup>2</sup>

There must be such agreement between the parties at least as to the nature of the contract and the nature of the identity of its object.<sup>3</sup>

Nowadays, the economic interdependence between the countries of the world has deepened through the process of globalization, manifested mainly by: internationalization of production and technology, goods, services

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<sup>1</sup> Vasile Pătulea, Corneliu Turianu, *Economic and Commercial Law - Institutions and Jurisdictional Practice*, Continent XXI Publishing House, Bucharest, 1996 pg 132-133

<sup>2</sup> *Idem*

<sup>3</sup> *Ibidem*

and capital markets, increasing complexity and diversity of production, trade and sales, increasing unprecedented speed, including through the expansion of e-commerce.<sup>4</sup> In addition to its economic role, international trade is an important factor in promoting understanding and cooperation between nations, an essential tool for strengthening the climate of trust, security and peace in the world. Therefore, international trade can be described as a true "*peace manager*".<sup>5</sup>

Romania, as a member of the UN, is a member of the United Nations Conference on Trade and Development UNCTAD. The main functions of the conference are in particular to promote the expansion of international trade in order to accelerate economic development, to formulate principles and policies for international trade and to promote their implementation, to take steps for the adoption of multilateral legal instruments in this field and to be the focal point for government policies and regional economic groups in the field of trade and development.<sup>6</sup>

The Lohn contract is the agreement of will between the manufacturer (executor) and the beneficiary (authorizing officer), the manufacturer engaging in to execute a custom product for the beneficiary in exchange for a renumbering and on the basis of a technical documentation provided by the authorizing officer.

As stated in the legal dictionary, the Lohn Contract is a contract whereby a manufacturer (executor) engages to execute a custom product for a beneficiary (authorizing officer), in exchange for a renumbering and on the basis of the technical documentation provided by the authorizing officer<sup>7</sup>. It is also known as "*custom production*"<sup>8</sup> because it is an international economic cooperation, where one party orders and the other executes on the basis of a contract.<sup>9</sup>

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<sup>4</sup> Dragoş Alexandru Sitaru, *International Trade Law - Treaty*, Universul Juridic Publishing House, Bucharest 2008, pg 12, 13

<sup>5</sup> *Idem*

<sup>6</sup> Dragoş Alexandru Sitaru, *International Trade Law - Treaty*, Universul Juridic Publishing House 2017, pg 14

<sup>7</sup> Legal dictionary, [https://www.advocate.ro/definitie\\_juridica\\_Contract\\_de\\_Lohn\\_](https://www.advocate.ro/definitie_juridica_Contract_de_Lohn_)

<sup>8</sup> Dragoş Alexandru Sitaru, *International Trade Law - Treaty*, Universul Juridic Publishing House 2017, pg 228

<sup>9</sup> *Idem*

## **MATERIAL AND METHOD**

The materials used in writing this paper are composed of specialized courses, treatises, legislation and web sites. The methods used are legal, namely the formal method, the historical method, the comparative method, the logical and sociological method, the analytical method. The use of these methods has the role of performing a systematic analysis of the information from the studied sources in order to elaborate the points of view and the conclusions.

## **RESULTS AND DISCUSSION**

The *lohn* contract and implicitly its use as a legal instrument in the production of goods is practiced in countries where labor is cheap. Through it, the beneficiary makes available to the manufacturer the raw materials, the execution documentation (models, projects, drawings) after which the finished product will be made or manufactured and establishes the technical and quality parameters of the finished product. In turn, the manufacturer undertakes to make the finished product in accordance with the technical parameters established by the beneficiary until a date provided in the contract.

Being a legal instrument through which rights and obligations are established, the *lohn* contract has the following legal characteristics: it is bilateral and synallagmatic because it creates mutual obligations between the contracting parties; it is consensual - because it is concluded by the agreement of the parties; it is onerous because both parties seek to obtain an economic interest; it is with successive execution because the obligations of the parties are executed in time.

The *lohn* system is preferred by entrepreneurs who have made investments and opened small factories, bought modern technology and want to recover them in the shortest possible time and ensure the continuity of production.

This type of contract is often encountered in the field of textiles. For example, the ordering party provides the raw material and technology to the executing party, and the executing party provides the ordering party with the production capacity, utilities, labor force and at the same time the production organization.<sup>10</sup>

The executor has only a small percentage of the profit, which doesn't allow him to develop the business, by his own forces. He thus remains dependent on the one who commands and the one who brings orders. And

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<sup>10</sup> Dragoş Alexandru Sitaru, *International Trade Law - Treaty*, Universul Juridic Publishing House 2017, pg 228

their volume must be very high, so that the income of the one who produces them also increases in direct proportion.

But the textile field is not the only branch where *lohn* is practiced. Another sector is that of information technology (IT), where Romanian programmers are paid several times less than their colleagues in the West.

Although *lohn* is considered a profitable type of transaction primarily for the beneficiary, it has been adopted as a mode of production by many Romanian companies. A sort of a necessary evil, because in many cases it was the only option for upgrading and investment or without orders (even with low profit), the factory would have closed its doors.

But companies based largely on *lohn* have little chance of development, precisely because the profits they make are visibly lower compared to exports made in their own name.

Until 2007, it was known as an import-export contract, but with Romania's accession to the European Union, this name was abandoned and it was called the *Lohn Contract*. At the level of the European Union we cannot speak of an import and an export but of *transport / commercial exchange*<sup>11</sup>, but nevertheless we can speak of import-export only at the level of Europe in relation to the non-European countries (ex: Romania exports the raw material to China) .

The modern age, but especially the contemporary one, has generated the unprecedented development, diversification and specialization of the market for goods and services. Under these conditions, the realization of a whole range of products and services necessary to meet its economic and social needs exclusively through the own means of a state has become practically impossible from a technical point of view and in any case economically inefficient. An interdependence was thus created between the national economies of different countries, which formed the basis of international economic exchanges.<sup>12</sup>

The *Lohn contract* is used by producers who need labor in economically underdeveloped countries, therefore, in addition to the low manufacturing costs charged under these contracts, the beneficiaries also have some security in terms of proper delivery of the finished product.<sup>13</sup>

According to a study published by the National Forecast Council (CNP)<sup>14</sup>, approximately 46.2% of Romania's total exports before joining the

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<sup>11</sup> [https://european-union.europa.eu/live-work-study/import-and-export\\_ro](https://european-union.europa.eu/live-work-study/import-and-export_ro)

<sup>12</sup> Dragoş Alexandru Sitaru, *International Trade Law - Treaty*, Universul Juridic Publishing House 2017, pg 12, 13

<sup>13</sup> Jenei, Cristina, *Buduşan and Associates - Lohn contract*, 12.05.2015, <https://www.budusan.com/articole/contractul-de-lohn>

<sup>14</sup> <https://cnp.ro/studii-si-analize/>,

EU were exports based on the Lohn system<sup>15</sup>. The best known example is the clothing, footwear and machinery industry, due to the low cost of labor and the need of Romanian companies to modernize their production capacity. However, with Romania's entry into the EU, Lohn-based production will be significantly reduced. A well-founded argument is that labor will migrate to the rest of the EU where wages will be higher, so that the relative surplus labor that was readily available until recently has disappeared.<sup>16</sup>

In addition, new competitors have appeared on the market using this economic activity, using a much cheaper labor force than the Romanian labor force. In this sense, the business of the Lohn contract in Romania has disappeared in recent years and will move to Asian markets where labor is much cheaper. For example, the company Nokia (from Cluj) gave up the labor force in Romania with the increase of the minimum income on the economy and led to the labor force in China.<sup>17</sup>

Analysis of the active improvement phenomenon (AP) or Lohn, in the context of globalization, must start from the concretion of the scope of the outsourcing operations which generally refers to the procurement of material inputs or services outside the country of residence of the company carrying out the operation. According to some estimates, is considered that in world trade, the commercial exchange in the inward processing mode represents about 40%. In general, for Romania, the phenomenon of inward processing (AP) presented a series of advantages, the most visible being the maintenance of jobs in the sectors that produced and exported in inward processing regime. But there were other benefits, such as the transfer of technology that accompanied foreign investment, increasing the qualification of the workforce and the managerial capacity, including in the field of marketing, as well as the competitiveness, the connection to its quality and control standards, specific to foreign markets, the contribution of the resulting foreign exchange to reduce the trade deficit and current account. The main features of the foreign trade carried out in the period 2001-2006 with light industry products resulting from inward processing are presented below.<sup>18</sup>

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<sup>15</sup> <https://cnp.ro/wp-content/uploads/2021/08/psaconsacnasocnasn.pdf>

<sup>16</sup> Jenei, Cristina, *Buduşan and Associates - Lohn contract*, 12.05.2015, <https://www.budusan.com/articole/contractul-de-lohn>

<sup>17</sup> *Idem*

<sup>18</sup> National Commission for Strategy and Forecast - Studies and analyzes - Light industry between regression and relaunch pg15 / 19, [https://cnp.ro/wp-content/uploads/2021/08/industria\\_usoara.pdf](https://cnp.ro/wp-content/uploads/2021/08/industria_usoara.pdf)

**Structura comerțului exterior cu produse ale industriei ușoare**

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	2001	2002	2003	2004	2005	2006
<b>EXPORT</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>
Perfecționare activă	96,4	94,8	93,7	92,4	90,6	88,3
Definitiv	3,6	5,2	6,3	7,6	9,4	11,7
<b>IMPORT</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>	<b>100,0</b>
Perfecționare activă	93,8	91,2	89,3	86,1	79,5	74,0
Definitiv	6,2	8,8	10,7	13,9	20,5	26,0

*Source: National Strategy and Forecast Commission - Studies and analyzes - Light industry between regression and relaunch pg15 / 19*

The analysis of the figures presented in the previous table shows a decrease in the share in the total branch, of exports with products of light industry under the IP regime from 96.4% as they represented in 2001, to 88.3% in 2006. The same phenomenon was felt in the case of imports of such products from 93.8% to 74%. In the period 2001-2006, there was a simultaneous decrease in the lohn, an increase in exports and imports in its own name by 8.1 percentage points and respectively 19.8 percentage points. At the level of 2006, from the point of view of the sales markets, the exports of light industry products, in active processing carried out with the EU member countries held approx. 90% of the total branch.<sup>19</sup>

The average number of employees in the light industry will continue in 2008, the downward trend, especially in the clothing sector, in which the number of employees will decrease by 5 000 people, mainly due to the decrease in related activities. In the textile sector, against the background of the increase of the industrial production, there is for this year a tendency to maintain the existing number. The average number of employees in the leather and footwear industry will remain in the trend of the last years of slight growth.<sup>20</sup>

The principle of international trade freedom knows certain limits, materialized by various instruments of trade policy that the state exercises over the activity of international trade of Romanian law subjects, under the restrictive conditions of the law.<sup>21</sup>

These trade levers have as purpose, mainly, trade restriction or stimulation with certain product categories, improving the structure of

<sup>19</sup> National Commission for Strategy and Forecast - Studies and analyzes - Light industry between regression and relaunch pg15 / 19, [https://cnp.ro/wp-content/uploads/2021/08/industria\\_usoara.pdf](https://cnp.ro/wp-content/uploads/2021/08/industria_usoara.pdf),

<sup>20</sup> *Idem*

<sup>21</sup> Dragoș Alexandru Sitaru, *International Trade Law - Treaty*, Universul Juridic Publishing House 2017, pg 21

Romania's foreign trade, protecting the internal market against unfair competition from abroad.<sup>22</sup>

## CONCLUSION

The main purpose of the *lohn* business is to produce articles by using locally qualified or unskilled labor, but which is considered cheap internationally. The raw material is imported, then processed and finally exported to the beneficiary or to the market designated by the beneficiary. Thus, the *lohn* contract is concluded between two foreign parties - exporter and importer or authorizing officer and executor - being considered an international contract in whose order the authorizing officer is a prestigious trading company, known on the international market. This type of contract is mostly used in the light, textile, footwear or clothing industries. *Lohn* implies the existence of a foreign company as a contractor or beneficiary that hires an executing producer for the latter to perform the necessary processing or manufacturing in order to obtain the finished products, following that these products will be shipped to the beneficiary. The foreign beneficiary is the company that launches the order and owns a well-positioned product brand on the market, and the producer or executor is a company that has low labor costs and the necessary production capacity. Being companies that are on different territories, there are advantages and disadvantages for both parties.

The advantages of the beneficiary are that he finds a material base - buildings, equipment, labour - in which he makes minimal investments and the labor force is much cheaper than in the country of origin, thus having the possibility to even increase its production. The advantage of the manufacturer is that it keeps the workforce busy. Of course, in this situation there are risks for both parties. For the beneficiary that the final product might be defective, and for the producer or executor to remain anonymous because the goods manufactured by him will be sold exclusively under the brand of the beneficiary. However, these aspects are discussed and negotiated by the parties before the contract is finalized.

The *lohn* processing operation was developed through the relocation by companies from developed countries of large industrial production consuming labour to countries in Central and Eastern Europe or other developing regions. *Lohn* processing is also known as *labor sales* because it represents the processing of materials, raw materials and semi-finished products belonging to one party (importer) by the other party (exporter).

The commercial operations executed on the basis of a *lohn* contract suppose a double activity of import and export. Thus, we speak of active *lohn*

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<sup>22</sup> Dragoş Alexandru Sitaru, *International Trade Law - Treaty*, Universul Juridic Publishing House 2017, pg 21

and passive Lohn. In the case of active Lohn, the exporter processes the materials made available to him by the importer and after making the finished products, they are re-exported to the beneficiary. In the case of passive Lohn, the importer sends the materials for processing to the exporter's country and returns them to the country of origin in finished form. For the beneficiary the operation is called passive Lohn and for the producer it is called active Lohn.

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