

## **Macroeconomics and Monetary Economics**

### **Debt Burden in Romanian Economy**

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**Abstract:** The paper treats the debt burden in Romanian economy. The rigidity of the structure of public spending has not allowed rapid adjustment to respond to massive reduction of production and income, reflected in excessive budget deficits and public debt doubled in a few years. The paper concludes that public debt which is poorly structured, is an important factor in macroeconomic instability and also in propagating economic crises.

**Keywords:** debt; crisis; Romanian economy; production; income

**JEL Classification:** H63; H68

#### **1. Debt Burden in Romanian Economy**

The international economic crisis effects that have been felt also among emerging countries in Europe have stopped positive growth and the nominal and real convergence process to which they have committed.

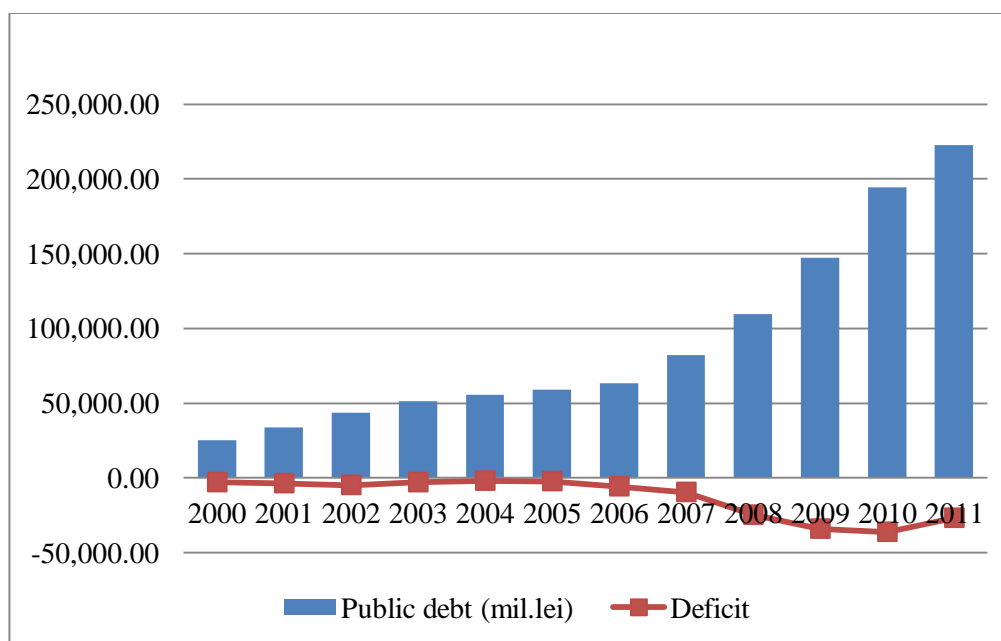
In Romania, the reduce of capital flows and the accumulated imbalances have worsened in recent years, being an important factor of vulnerability to macroeconomic stability reflected in excessive widening budget deficit and a corresponding increase in public debt.

During 2000-2011, Romania's public debt showed a continuing increase, accelerating the pace of 2007, when it increased by almost 30% since 2006.

The increasing in time of the public debt was accompanied by a significant increase in government spending, well above the economy's capacity to fund, inevitably leading to worsening economic conditions in the long term.

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**Figure 1. The evolution of public debt and budget deficit during 2000-2011 (mil. lei)**

*Source: INSSE*

In 2007-2009, public debt increased considerably in most countries affected later by the economic crisis. Even countries that have not experienced drastic decreases in economic activity occurred in this period an increase in debt of about 20% in real terms as a result of safety measures to prevent a stronger shock (Reinhart & Rogoff, 2010).

Although the ratio of public debt/ GDP is below 60%, while accumulating involved and involves considerable risks for macroeconomic stability. Accelerating the pace of debt generated on the one hand a sensitive repayment capacity gradually with decreasing national income and, on the other hand, an increase in interest rates.

At the onset of the economic crisis, the Romanian state as debtor was suddenly deemed insolvent and when the probability of default increased, the external funding decreased, resulting in lower aggregate demand (consumption and investment), increasing unemployment rates, decreased production. In other words increasing nominal debt increases real volatility, financial fragility and reduces average growth (Cecchetti, Mohanty, & Fabrizio, 2011).

Debt or the opportunity cost of public goods funded by it becomes a burden on the economic development. For Romania, this opportunity cost is the private investment given up in favor of public goods.

A public debt even higher than that of Romania, can be regarded as a positive influencing factor in strengthening the real economy if deficits are used for investments with higher return than the cost of financing and not for consumption or social and labor contributions.

Given that GDP grows faster than interest and fees on loans, the state would not have to resort to raising taxes by transferring the burden of debt on future generations. How in Romania have turned to new loans or to others rolling for interest payments, this is only a postponement of the problem, experience showing that the effects will be seen on fiscal policy (Barro, 1979, pp. 940-971).

During 2000-2011, the share of government debt to GDP while remaining below the threshold specified by the Maastricht Treaty, increased solvency risk because the average growth rate of government debt was 21% per year and the average rate of growth was about 4%.

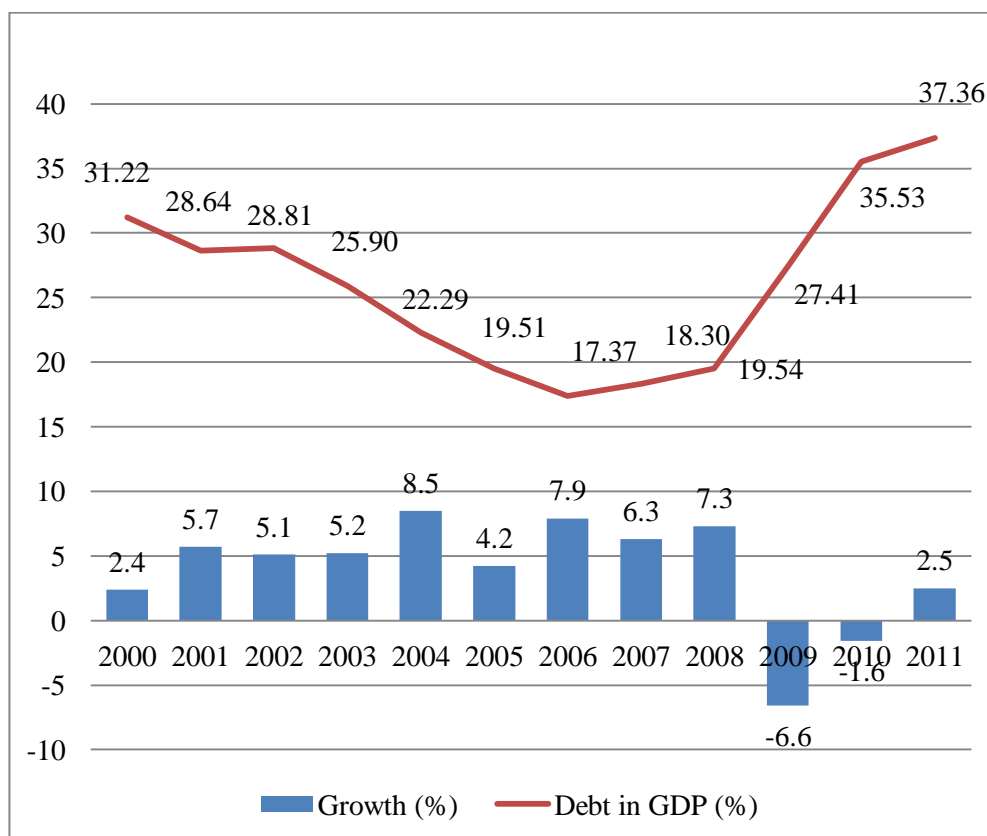
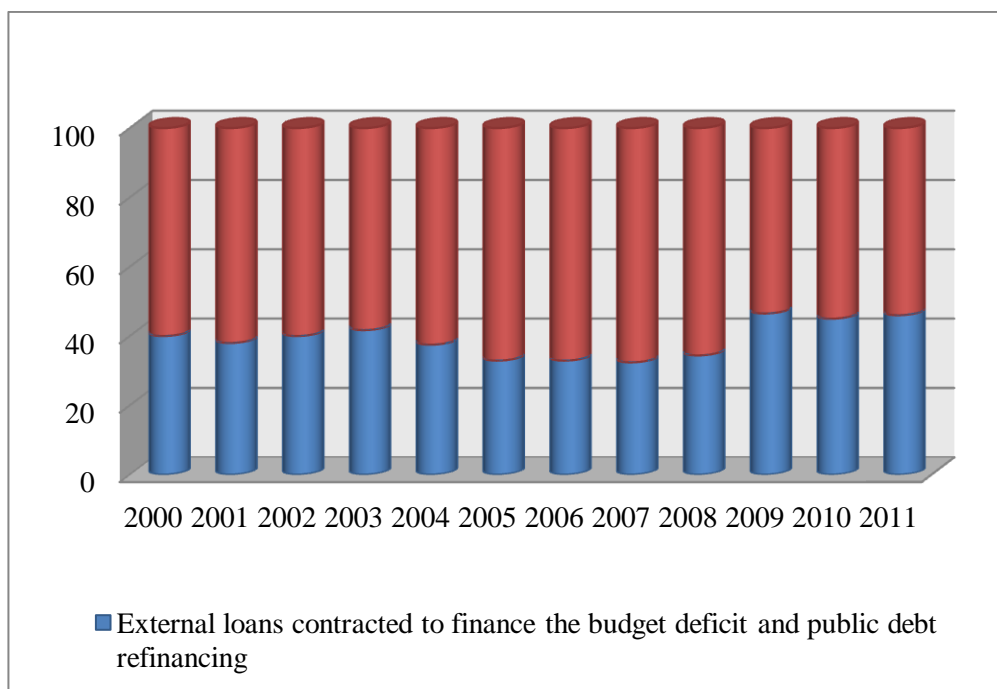


Figure 2. Debt in GDP and growth (%) in Romania between 2000-2011

Source: NBR, INSSE

In the 10 years analyzed in this economic research, foreign government debt ratio of total government debt outpaced domestic government debt ratio till 2006. Since 2007, relations have changed due to the fact that the state turned to a greater extent on domestic creditors. Unsustainability of debt is reflected largely by external borrowing wrong destination. In Romania, compared to European countries, a low share of foreign debt was allocated funding effective investment, generating jobs leading to increased production and sustainable economic progress. Without these investments became very difficult to create sources to finance the budget deficit and public debt service coverage. The lowest level of external borrowing for investment projects funding occurred in 2009 (53.5% of total external debt) when financing deficit increased costs due to tensions and instability in international markets.



**Figure 3. Destination of foreign loans during 2000-2011 (% of total external loans)**

*Source: Ministry of Finance, NBR, the Court of Auditors*

The indebtedness to foreign country and foreign effort made are below:

Table 1. Main Indicators of External Debt

Year Indicator	Coverage of imports by reserves (months imports)	MLT external debt ratio of external debt to GDP	Share in total exports MLT	External debt service ratio MLT
2000	3.3	26.9	84.4	20
2001	3.9	29.4	87.3	21.4
2002	4.7	33	93.1	18.8
2003	4.2	33.4	84.2	17.6
2004	5.2	30.1	83	18.4
2005	6.3	30.8	93.2	20.1
2006	6.4	28.5	90.8	19.5
2007	6	31.2	102.1	21.8
2008	5.7	37.1	119.6	29.3
2009	8.5	56.5	181.9	33.1
2010	8.6	59.4	165.6	33.3
2011	7.5	55.4	144.3	28.3

Source: NBR

**The coverage of imports by reserves** (months imports) calculated as the ratio of international reserves (foreign exchange and gold) and average monthly imports of goods and services (imports listed in the future) is an indicator showing foreign reserves capacity to finance economic activities in conditions of low liquidity and solvency. For international reserves represent a shock absorber in this case, the value of this indicator should not be more than 3-4 months.

**The share of external debt in GDP on medium and long term** is a relative indicator that shows how much of the added value achieved by Romania would be required to repay foreign debt. From the data above, we see that since 2009, foreign indebtedness increased significantly, more than half of the newly created being burdened by external debt.

**The share of the foreign debt on medium and long term in total exports** is an important indicator that expresses indirect financial effect of indebtedness to the rest of the world. As with the previous indicator, it increased also significantly since 2009, which means that we need many more annual exports for contracted debt repayment and interest on outstanding loans. How much this index increases the effect of external debt influences the purchasing power of the country's exports.

**The share of the foreign debt on medium and long term** is the ratio of external debt to exports of goods and services and represents the share of debt service (repayment of principal repayments and payments and interest payments and commissions) in total foreign exchange inflows from exports. Currency depreciation since 2009 has increased this indicator by almost 13% with 2008. The

effect of the increase of this ratio is, on the one hand, an increase in prices of intermediate inputs and capital goods imported without a significant improvement in the ability to import (import compression) resulting in a contraction of aggregate supply and investment. On the other hand, rising prices of intermediate and capital goods imports may lead to a greater demand for unskilled workers if the labor market skilled labor and unskilled are net substitutes (Tiruneh, 2004).

At a level above 20% of this indicator, it increases the financial burden of repayment of external debt.

## 2. Conclusions

From the above, we see that the rigidity of the structure of public spending, has not allowed rapid adjustment to respond to massive reduction of production and income, reflected in excessive budget deficits and public debt doubled in a few years.

Also, we can conclude that public debt (domestic and external) which is poorly structured, whether we refer to the purpose for which it was contracted, or interest rate, currency denomination, or in terms of maturity, is an important factor in macroeconomic instability and also in propagating economic crises.

## 3. References

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