

## **Business Administration**

### **Romania's Foreign Debt: Trend, Structure, Indicators**

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**Abstract:** The foreign debt is a solution for supplementing the internal savings. The objectives of the article<sup>2</sup> are to analyze the evolution of Romania's medium and long-term foreign debt and of its components between 2005 and 2013, as well as the structure by creditors of the medium and long term Romanian public foreign debt, to highlight some of the causes that explain its evolution and structure and to show if Romania's foreign debt is sustainable, using comparative analyses, qualitative and quantitative evaluations, interpretations and correlations. The results of the analysis show that 2009 has represented a turning point in the evolution of the Romanian foreign debt on the medium and long term and its components. Also, although the values of the analyzed external debt indicators still show a good payback and indebtedness capacity of our country, a complex and coherent reimbursement strategy must be developed in agreement with the progress of the economic reform. An indebtedness strategy should also be drawn up, taking into consideration an optimal ratio between the different maturities of foreign debt, in order to avoid payback peaks.

**Keywords:** creditors; debt sustainability; indebtedness strategy; reimbursement strategy; external debt indicators

**JEL Classification:** F21; F34

## **1 Introduction**

The foreign debt<sup>3</sup> is a solution used to supplement the internal savings, which gives the country receiving the loan, the possibility to finance a higher volume of investments than possible when using only the domestic resources. The foreign debt also supplements the internal credit and maintains the demand within

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<sup>3</sup> The definition of the foreign debt given internationally presents gross foreign debt, at a particular moment, as the "total amount of the contracted loans, used and not paid back, up to that particular moment, from the foreign financial markets, and the obligation of the residents to reimburse the capital installments and the related interest".

convenient limits. Also, it improves the standard of living and supports the transition process. The foreign loans can be also used to refinance the temporary deficits of the balance of payments, providing an alternative to the reduction of the internal consumption. (Milea, 2009) The foreign financing provides access to more debt instruments, which allows a more efficient management of the risk and of the cost of debt, which can thus be cheaper than the internal financing.

The article analysis the evolution of the medium and long-term foreign debt and of its components from 2005 to 2013, as well as the structure by debtors of the medium and long-term external public debt of Romania. In addition to other existing studies (Monthly Bulletins and Annual Reports of the National Bank of Romania), the author aims to highlight some of the causes, which explain the evolution and structure of the Romanian foreign debt. Finally, the author calculates some of the foreign debt indicators and shows whether they have had sustainable levels. The methodology used consists in comparative analyses, qualitative and quantitative evaluations, interpretations, correlations and proposals of measure.

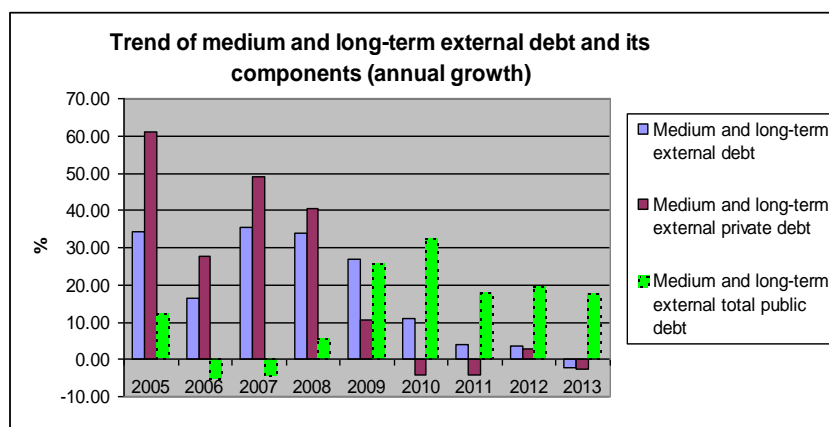
In Romania, the slow and insufficient pace of the structural reforms has led to a structural imbalance of the economy, which generated considerable deficits of the current account and of the consolidated state budget, produced by an economy, which consumes more than it produces. Given a low rate of the internal accumulation, these deficits and the internal absorption for consumption and investments have been covered by foreign savings, either as investments, or as loans, which have increased gradually the foreign debt. Thus the medium and long-term foreign debt has increased almost continuously starting with 1990, 2013 being the first year when the foreign debt has decreased. The external public debt has also increased almost continuously after 1990, peaking in 2009-2012, when Romania has taken a foreign loan from the international financial organizations.

Although as a proportion of the GDP, the medium and long-term Romanian foreign debt is within the limits that are considered sustainable internationally, it is necessary an analysis of the causes which have lead to this ever increasing trend of the foreign debt in Romania and of how much the foreign debt has supported the economic growth of Romania. Thus, it is acceptable that a country increases the volume of foreign loans, as long as the marginal product of the borrowed capital is higher or equal with the cost of the loans, because, only in this situation, the increase of the foreign debt improves the growth rate of the national income. The foreign loans do not contribute to the economic growth if they are used inefficiently (i.e. to finance unproductive activities such as the consumption, to balance the excessive exports of capital, or with lower yields than the interest rate paid for them); on the contrary, they lead to the necessity to take more loans, which eventually limits the access of that country to foreign financing and even to a foreign debt crisis. (Milea, 2009)

## 2. The Evolution of the Medium and Long-Term External Debt and of its Components

The medium and long-term external debt has increased continuously in Romania after 1990. This evolution had a moment of change in 2013 when the medium and long-term external debt decreased for the first time after 1990 (see Figure 1).

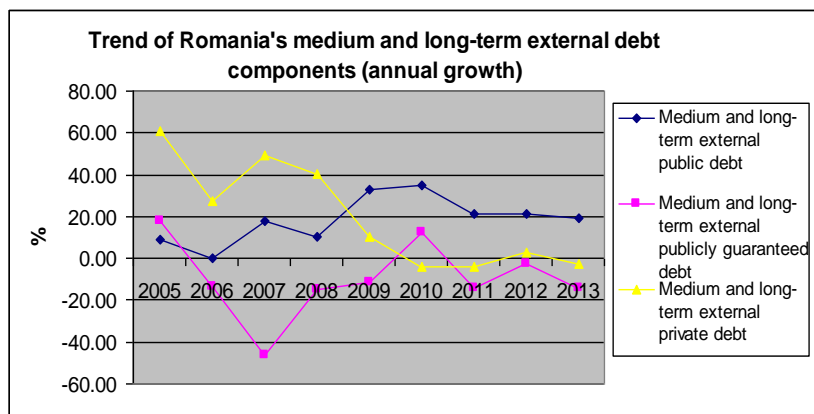
The external public debt has increased almost continuously from 2000 to 2013.



**Figure 1. Trend of Romania's medium and long-term external debt and its components (%)**

*Source: Author's calculations based on NBR data*

A point of turn in the evolution of the medium and long-term external debt and its components has been in 2009 (see Figures 1 and 2).

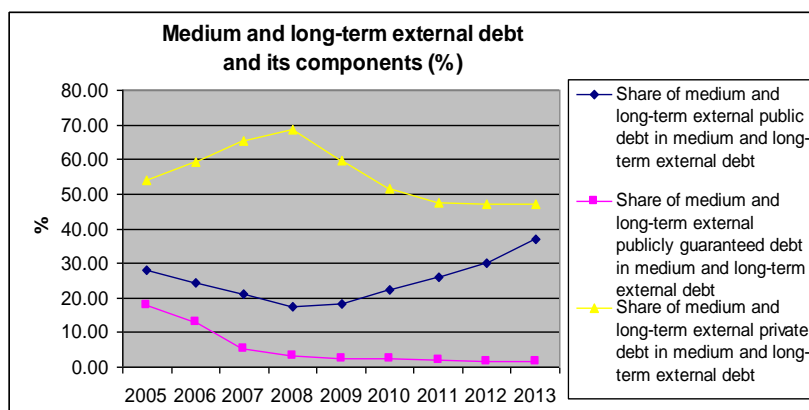


**Figure 2. Trend of the components of Romania's medium and long-term external debt (%)**

*Source: Author's calculations based on NBR data*

Thus, the medium and long-term external public debt has increased strongly, while the external private debt and the external publicly guaranteed debt have decreased beginning with 2009 (see Figures 1 and 2). The evolution of the external public debt is explained by the 20 billion Euro loan received from the international financial organizations (the International Monetary Fund, the European Commission and the World bank), which was cashed between 2009 and 2012, loan used for internal financing. This was due to the lower inflow of “free” capitals in the context of the higher risk aversion of the investors and of the lower level of international liquidity.

Within this context, the proportion of the external public debt within the total external debt has increased starting with 2009 (see Figure 3).



**Figure 3. Share of the components of Romania’s medium and long-term foreign debt in the external debt (%)**

*Source: Author’s calculations based on NBR data*

The steep slowdown of the growth trend of the external private debt in 2009 and its decrease in 2010, 2011 and 2013 (see Figures 1 and 2) is due, among others, to the lack of liquidities, to the significant decrease of the economic activity and to the risk aversion of the creditors following the economic financial crisis and its effects. Before 2009, during the years that preceded the crisis, the foreign debt of the private sector increased significantly on the background of the optimism generated by the economic boom. The increase of the external private debt was also noticed in 2012, but at a lower rate.

It has been noticed that many times, the private sector preferred to borrow from the foreign markets, against a rather advantageous external cost compared to the cost of the internal sources of financing, under the given circumstances of some key-variables of the Romanian economy (high interest rates for credits, over-evaluated

real exchange rate of the national currency, excessively prudent behaviour of the local banks in the lending process).

From 2005 to 2010, the private foreign debt represented the majority of the medium and long-term foreign debt of Romania (see Figure 3), which shows a high dependence on the foreign financial markets within a context of risk and uncertainty both for the debtors and for the creditors. A good evolution for the sustainability of the Romanian foreign debt is represented by the decrease of the external private trade debt as of 2009 (see Figure 3).

We notice that in 2013, the external public debt has witnessed an “unexplainable” evolution. Thus, although Romania has returned 4.6 billion Euros to the International Monetary Fund, the external public debt of Romania has increased in 2013. Another significant fact is that the reserves assets of the National Bank of Romania have grown the same year. Analyzing the evolution of the other components of the financial account we find partially the explanation of this seemingly paradoxical evolution. Thus, although in 2012 and 2013, Romania has returned large amounts of funds to the International Monetary Fund, the external public debt has not decreased because Romania has borrowed large amounts of capitals from the international bonds market, and she has also received other funds from IBRD and EIB. This evolution is reflected by the balance of the portfolio investments account which, in 2011, 2012 and 2013, has had extremely high positive values compared to the previous period. Thus, the institutional creditors have been replaced with private creditors. Given that the debt from the multilateral institutions has lower costs, taking into account the interest rate for the countries rated as risky on the private market of the international capital; longer period of grace; longer total duration; the replacement of the creditors represents an extremely negative evolution for the Romanian economy. Instead of returning the foreign debt, Romania has borrowed more, under more harsh credit conditions (Milea, Ailincă, Bălăşescu, 2013). However, the issue of bonds does not explain all the increase of the external public debt. And there have not been other inflows of foreign capital registered into the capital and financial account of the balance of payments. Under these conditions, the question rises about the origin of the funds that have determined the increase of the external public debt in 2013 and why they are not recorded into the balance of payments?!

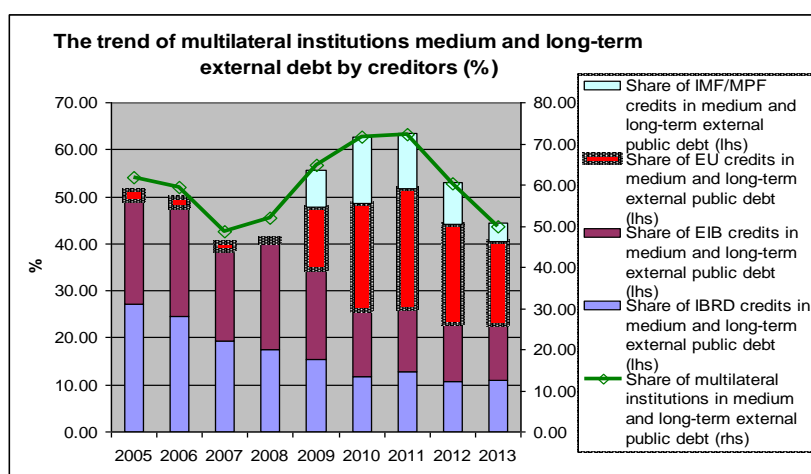
In conclusion, in the context of the almost continuous increase of the external public debt, it is absolutely necessary to draw a complex and coherent strategy for the reimbursement of the foreign debt, in agreement with the progress of the economic reform and with the restructuring of the national economy. A debt strategy must also be developed, in order to establish an optimal ratio between the medium and long-term debt, on the one side, and the short-term debt, on the other

side, between their maturity dates, so that the burden of the foreign debt to be distributed uniformly over the years, thus avoiding payment peaks.

### 3. Analysis of the Structure by Creditors of the Medium and Long-Term External Public Debt

The multilateral credits represented the majority of the medium and long-term external public debt in almost every year of the period analyzed (except 2007 and 2013) (see Figure 4), which show the need of the Romanian economy for external financing, both during the period of economic boom, and especially within the context of the world economic and financial crisis, 2009 and 2010 showing an important increase.

The shares held by the European Union and by the International Monetary Fund within the medium and long-term external public debt have increased significantly in 2010 and 2011 due to the loan received by Romania from these two institutions, while the shares held by IBRD and EIB have decreased in a discontinuous manner (see Figure 4).



**Figure 4. Share of the different multilateral institutions in the medium and long-term foreign public debt of Romania (%)**

*Source: Author's calculations based on NBR data*

The loans received from official creditors have several advantages: lower costs taking into account the interest rates charged to the countries perceived as risky on the private market of the international capital; longer period of grace; longer total duration, which eases the repayment effort. These credits have also disadvantages,

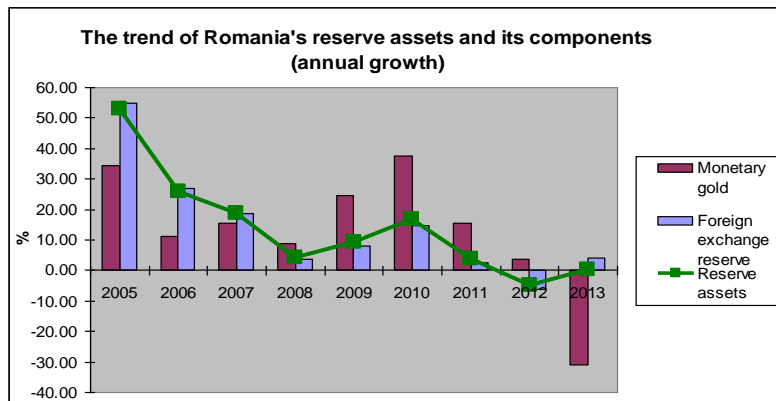
however: the funds available are limited; the high use of this kind of financing conveys a negative message to the foreign investors, because exceptional financing is intended to cover the current account deficit and to support the efforts of structural adjustment of the beneficiary economy. In conclusion, this signal points to reform efforts that have been never accomplished. (Milea, 2009).

#### 4. The Structure of the Reserve Assets of the National Bank of Romania

The reserve assets of the National Bank of Romania have increased almost continuously (except for 2012), evolution, which shows the solidity and credibility of Romania from the financial-banking point of view. These capitals should be, however, consolidated by adequate public policies which should value them, and by making adequate use of them with yields as high as possible.

Although the monetary gold has a small share within the reserve assets of NBR, its value has increased significantly between 2009 and 2011. However, the value of this reserve asset has decreased drastically in 2013 (see Figure 5).

2012 represents a particular situation, because the reserve assets of the National Bank of Romania, through its component the foreign exchange reserve, have decreased significantly because Romania has returned a significant part of the loan from the International Monetary Fund (see Figure 5).



**Figure 5. The Annual Growth of Romania's Reserve Assets and its Components (%)**

*Source: Author's calculations based on NBR data*

## 5. Analysis of the Indicators of External Debt of Romania

Based on the above analysis, taking into account the level of the external debt to be returned and the sources for financing it, the authors will calculate and explain the evolution of some of the indicators of external debt of Romania from 2005 to 2013.

**Table 1. External Debt Indicators in Romania**

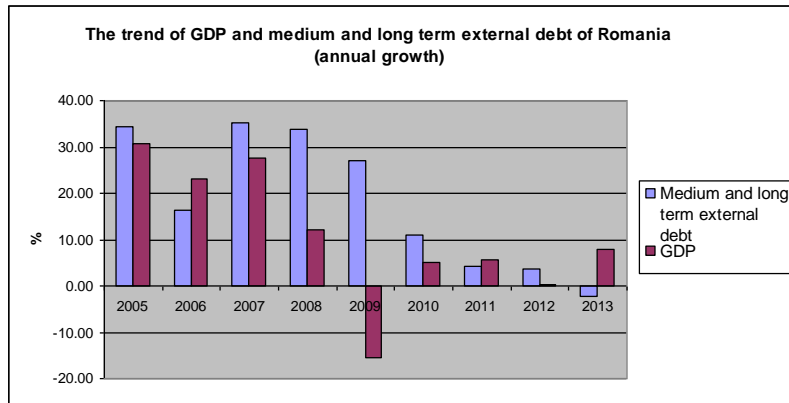
Indicators	2005	2006	2007	2008	2009	2010	2011	2012	2013
$ED_{MT}/GDP$ (%)	30.9	29.3	31.1	37.0	55.6	58.6	57.8	59.8	53.9
$ED_{MLT}/EXP$ (%)	93.2	91.0	106.1	121.9	181.9	165.7	144.5	147.3	128.5
FER/IMP (months)	6.3	6.4	6.1	5.6	8.5	8.4	7.5	7.1	7.0
FER/ $ED_{MLT}$ (%)	74.3	80.1	70.2	54.6	46.9	49.3	49.1	45.0	46.0

*Source: Author's calculations based on NBR data*

On the background of the almost continuous increase of the exports of goods and services, of Romania's reserves assets and of the medium and long-term external debt, the external debt indicators that we have calculated have remained within the limits that are considered normal at the international level, almost throughout the entire analyzed period (see Table 1)

*The medium and long-term external debt within the GDP ( $ED_{MT}/GDP$ )* displayed spectacular leaps in 2008 and, particularly, in 2009. This is explained by the increase of the external public debt due to the 20 billion Euros loan taken by Romania from the international financial organizations, which was cashed in between 2009 and 2012. The increase of this indicator during the analyzed period also shows that the medium and long-term external debt has increased faster than the growth of the GDP (see Figure 6). The evolution of this indicator shows the decrease of the medium and long-term external debt in 2013. Although the value of the medium and long-term external debt within the GDP is not very large, as compared to the international standards, the rate of growth of this indicator represents a sign of alarm, which requires a careful monitoring and the adoption of a coherent strategy of the external debt. An excessive increase of the share of the external debt within the GDP involves an increased probability of future difficulties in securing the service of the external debt. Therefore, such a country would be compelled to increase the fiscal burden of the economic agents or to depreciate its national currency, on the condition that the evolution of exports is elastic in terms of price, in order to get the funds necessary to pay back the external debt.

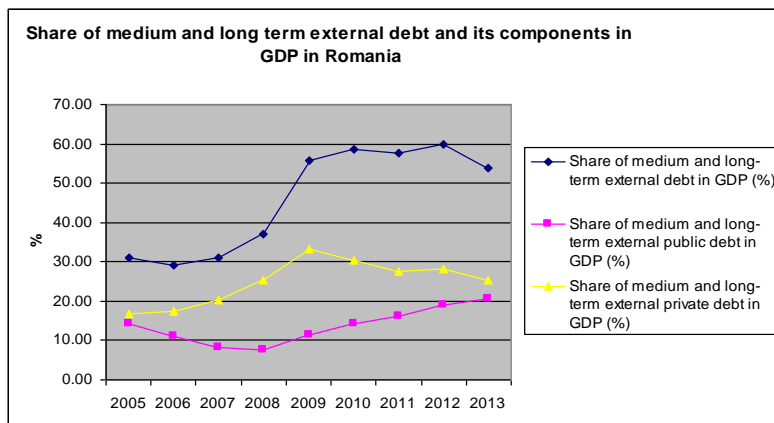




**Figure 6. The Annual Growth of Romania's GDP in Comparison with the Medium and Long-Term Foreign Debt (%)**

*Source: Author's calculations based on NBR data*

If we analyze the evolution of the medium and long-term external debt within the GDP by its components (external public debt and external private debt), we notice that throughout the period 2005-2013, the share of the external public debt within the GDP has been below the share of the external private debt within the GDP; we can also see that the share of the external public debt within the GDP has increased and the share of the external private debt within the GDP has decreased starting with 2008 (see Figure 7). This evolution can be looked at as positive, considering that the external public debt is more sustainable than the external private debt.



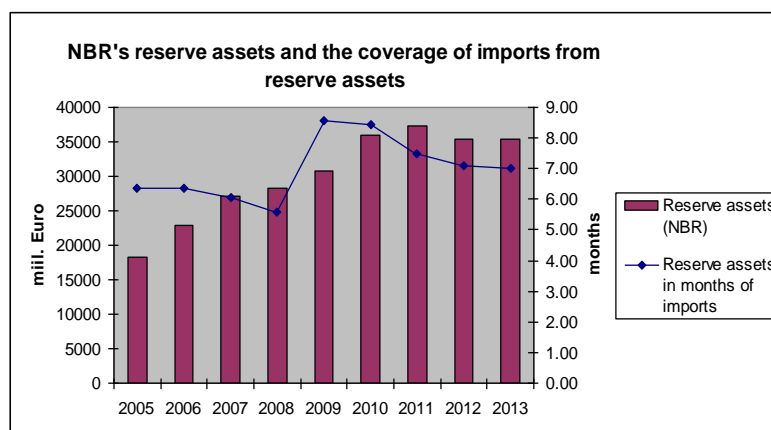
**Figure 7. The Share of Medium and Long-Term Foreign Debt and its Components in GDP in Romania (%)**

*Source: Author's calculations based on NBR data*

The significant increase of the indicator *medium and long-term external debt within exports* ( $ED_{MLT}/EXP$ ) between 2006 and 2009, on the background of the continuous increase of the exports (except 2009), shows an evolution of the medium and long-term external debt that needs to be monitored in order to avoid the payback peaks and the excessive repayment burden of Romania. It is also absolutely necessary that the credits should be used either for projects that have higher yields than the interest rate at which these capitals have been obtained, or to support the economic revival and the economic growth, and not for unproductive consumption. A positive evolution is represented by the decrease of this indicator starting from 2010, on the background of an increase of the exports, although the medium and long-term external debt has also grown during this period (except in 2013). Although the share of the external debt within the exports has remained below the critical international level, after 2008 it has approached much to this level. The strong increase of this indicator is explained by the higher rate of growth of the medium and long-term external debt compared to the rate of growth of the exports; this situation was understandable during the early years of transition, but it still continues, affecting negatively the economy. If the external debt would be a boosting factor for the exports, the ratio of the external debt to the exports would have a decreasing or, at least, a constant trend.

If the expenditures financed through external debt contribute only to the increase of the demand for loans, and not to the improvement of the production capacities, the exports will not be able to increase sufficiently in order to generate the improvement of the balance of payments and of the payback capacity. It might even be necessary to take more loans in order to prevent the decrease of some imports needed for exports, which support the payment of the external debt. Therefore, the external debt would continue to increase faster than the exports.

The increase of the reserve assets throughout the period 2005-2013 (except 2012), and even before 2005, has generated the improvement of the *coverage of imports from the reserve assets* ( $FER/IMP$  (months)), this indicator reaching a maximum level of 8.5 in 2009 (see Table 1, Figure 8). The rate of imports coverage from the reserve assets has been, throughout the analyzed period (except 2008), above the 6 months limit, which is internationally considered as maximum. The improvement of this indicator is due to the increase of the reserve assets through purchases of hard currency from the exchange rate market, these amounts resulting from direct and portfolio investments of non-resident entities, from privatizations, from public external loans and from issues of state bonds on the international markets.



**Figure 8. The Coverage of Imports from Reserve Assets and the Reserve Assets of the National Bank of Romania (%)**

*Source: Author's calculations based on NBR data*

*The ratio of the reserve assets to the medium and long-term external debt ( $FER/ED_{MLT}$ ) has exceeded the low critical limit in almost all the years of the analyzed period. This indicator was minimal in 2009 (when the medium and long-term debt has increased significantly) and in 2012 (when the reserves assets have decreased).*

The values of the analyzed debt indicators show a still good indebtedness and reimbursement capacity of the external debt of our country.

In conclusion, in the last years, Romania needed external financing for the balance of payments, for structural adjustments, to finance the state budget and some investment projects and to consolidate its reserve assets. This external financing, needed to complete the internal resources, has generated external debt, which is still within sustainable parameters, as seen from the analysis of the external debt indicators. Considering that the external debt service is rather high, the real economy doesn't show signs of complete recovery from the crisis, while the further build up of deficits financed by flows which generate external debt may shortly bring to critical levels of the indebtedness level of our country, it is necessary that the external debt management and the strategy for external indebtedness should be a part of the macroeconomic policies elaborated by the decision factors. Other worrisome reasons are the accelerated increase, over the recent years, of the share of medium and long-term external debt within the exports and of the rate of the external debt within the GDP. (Milea, 2009)

## 6. Conclusions

Any external credit must be justified economically, commercially and politically, for its intrinsic value.

Any country should maintain a debt capacity which allows it to cope with unpredictable situations, such as the need of emergency loans to equilibrate the balance of payments.

2009 has been a turning point in the evolution of all types of external debt of Romania. Thus, the external private debt slowed down abruptly its increase in 2009, and has decreased during the following years, due to the lack of liquidity, to the significant reduction of the economic activity and to the risk aversion of the creditors, generated by the economic and financial crisis and its effects.

The medium and long-term external public debt increased significantly between 2009 and 2011 due to the foreign loan taken by Romania from the international financial institutions, because the internal resources have been considered to be insufficient.

Most of the medium and long-term external public debt comes from multilateral creditors in almost every year of the analyzed period. This shows the interest of the international financial organizations for the evolution of the Romanian economy, and the needs of the Romanian economy for external financing both during the economic boom and, particularly, within the context of the world economic-financial crisis.

2012 and 2013 showed extremely high values of the inflow of portfolio investments compared to the previous period. As a personal contribution, I notice that the institutional creditors have been replaced by private creditors. In the context in which the debt from the multilateral institutions has lower costs, considering the interest rate charged to the countries perceived as risky on the international private capital market; it has a longer period of grace, a longer total period; I draw attention on the fact that the replacement of the creditors represents a deeply negative evolution of the situation of the Romanian economy. Instead of paying back the contracted external debt, our country makes more debts, in harsher credit conditions. I also highlight that the issue of bonds does not explain all the increase of the external public debt. Considering that there have not been other inflows of foreign capital registered into the capital and financial account of the balance of payments, the question rises about the origin of the funds that have determined the increase of the external public debt in 2013 and why they have not been recorded into the balance of payments?!

The analysis of the debt indicators shows that the external debt has not been used for profit yielding, productive purposes, for generating economic growth and the

increase of the gross domestic product, but for other purposes, among which non-productive consumption. Therefore, the increase of the external debt at the rates at which it had taken place has not been justified by the economic growth. The long-term use of a significant part of the external debt for non-productive consumption distorts the prospects for normal reimbursement of the external debt, which will eventually lead to seeking emergency solutions to avoid the loss of liquidity, or, even worse, the state of default.

Given these evolutions of the external debt and its components, although the values of the analyzed external debt indicators still show a good payback and indebtedness capacity of our country, a complex and coherent reimbursement strategy must be developed in agreement with the progress of the economic reform and with the reorganization of the national economy. An indebtedness strategy should also be drawn up, taking into consideration an optimal ratio between the medium and long-term debt and the short-term debt, namely between their due dates, so that the burden of the external debt should be spread uniformly along the years, thus avoiding payback peaks.

A positive aspect consists in the fact that all along the analyzed period, the reserve assets have consolidated, while its exchange rate structure has harmonized with the exchange rate structure of the medium and long-term debt and of the medium and long-term debt service. The almost continuous increase of the reserve assets (except 2012) shows the financial and banking solidity and credibility of Romania.

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