ROMANIA'S PUBLIC DEBT IN CRISIS TIME

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ABSTRACT

This study investigates Romania's government public debt in this sensitive period of global economic and financial crisis. The study has revealed that Romania's public debt can be considered sustainable because the level of indebtedness is below the one set by Maastricht criteria. The paper provides a rational background for finding solutions to the problems encountered by the state in order not only to surmount the economic crisis, but to upturn the international investments in Romanian infrastructure. The findings of this study may be used as a starting point for policy making in the fields of public investments and government public debt management.

KEY WORDS: *Economic crisis, Public debt, External public debt, Public debt management, Risk*

1. Introduction

This study examines the government public debt in Romania by taking into account the impact of the world economic crisis on Romania's economy. The manner in which the government public debt is managed in this period of crisis is a highly debated topic these days because of its imperative role and major implications for the Romanian economy.

The study was carried out by combining a choice of sources, such as strategies, statistical documents, as well as articles and research reports. In order to answer the research question we have outlined the impact of the world economic crisis on Romania's economy. Furthermore, we have analyzed the government public debt by instruments and currencies and also the external public government debt service. The study has revealed that Romania's public debt can be considered sustainable because the level of indebtedness is below the one set by Maastricht criteria. The research question was answered by analyzing published sources and interpreting evidence.

2. The impact of the world economic crisis on Romania's economy

The effects of the international financial crisis have expanded into the Romanian economy on various channels (Isărescu, 2009; Popa, 2009):

1. The commercial channel (slow down or even reduction of the exports amount);
2. The financial channel (limited access to external financing, credit amount reduction, difficulties related to the private external debts service);
3. The exchange rate channel (reduced external financing, which materialized in depreciation of the national currency);
4. The trust channel (withdrawal of foreign investors from the Eastern-European countries, panic and speculative attacks on the monetary market); and

5. The wealth and balance sheet effects channel (deterioration of the people' and companies' net assets, due to the high share of foreign currency credits correlated with the depreciation of the national currency and the decrease of speculative, unsustainable prices for movable and immovable assets).

In Romania, the effects of the economic crisis are visible in all areas of economic activity. Romania's economy has been hit hard by the global economic downturn. For instance, the gross domestic product, the financial markets, the fiscal deficit, the exchange rate and the government public debt are all affected by the world economic crisis. Romania undergoes large contractions in 2009, and the recovery is likely to be feeble and uneven.

Economic activity declined roughly in the last quarter of 2008 and has fallen further in early 2009. Real gross domestic product (GDP) growth changed from an average of 9% (quarter on quarter annualized) during the first three quarters of 2008 to a 13% decline in the fourth quarter. The turn down of the real GDP was driven primarily by a drop in domestic demand. The export growth was also slowed down and imports dropped even more sharply, therefore the correction in the current account deficit began towards the end of 2008. For the first quarter of 2009, early indicators (confidence, industrial production, retail sales and tax revenues) all point to a continued sharp drop in GDP, along with rising unemployment as well as poverty incidence (World Bank, 2009b, p. 9).

The effects of the global crisis and economic downturn severely affected the asset and financial markets. The stock market has lost 65% of its value since the peak in August 2008. The inter-bank market was disrupted in October 2008 by rumours of liquidity problems at a commercial bank, leading to a spiking of rates; these rates remained relatively high thereafter due to lingering concerns about counterparty risk, high risk aversion, and market segmentation due to an uneven distribution of assets (T-bills) eligible for discount with the National Bank of Romania. Balance of payment pressures drove a 15% depreciation of the national currency (RON) against the Euro from October 2008, putting pressures on household, corporate and bank balance sheets. To dampen currency volatility, the central bank intervened in the spot market. Despite the depreciation, financial conditions tightened significantly on increased sovereign credit default swap premium and monetary policy tightening. Romania's international credit rating was cut in late 2008 by a larger margin than those of other countries in the region, reflecting market concerns about the sustainability of Romania's large current account deficit, uncertainties surrounding the outlook for fiscal and incomes policies, and the financial health of banks with subsidiaries or branches in Romania. This has converted into significantly higher external borrowing costs for Romanian banks and companies (World Bank, 2009b, p. 9).

The financing of the fiscal deficit has been increasingly concentrated at very short maturities due to the worsened conditions in the financial markets. As a result, the Government has been exposed to roll-over risks in the current environment of de-leveraging.

The macro-financial environment has downgraded during 2008-2009 period of time, and this fact has created risks for financial stability. The liquidity risk has become substantial given that the difficulties in parent banks and the downgrading of Romania's sovereign rating to below investment grade by major international ratings agencies in late 2008. As a result, a decline in the capital account flows has become visible. A sharp contraction or reversal of inflows could threaten macroeconomic and financial stability through a drying up of credit to the private sector, resulting in an even sharper slump in economic activity and larger increases in loan defaults. Also, a reversal of capital inflows would put additional downward pressures on the exchange rate. Banks have substantial indirect foreign exchange risk exposures, in the form of credit risk. The rapid downgrade of the economic conditions and depreciation of the national currency (RON) may place strains on bank capital positions. The banking system entered the crisis well capitalized and with high liquidity buffers. The parents of most foreign owned banks have agreed to maintain lines of credit to their subsidiaries and borrowers in Romania and to raise their capital in order to comply with the minimum agreed level of solvency. Additionally, banks will need to be proactive in enhancing loan quality by developing and implementing effective debt restructuring or workout procedures for household and corporate clients (World Bank, 2009b: p. 10).

Romanian economy recovery may last more than expected. The Government of Romania is confronted with the difficult challenge of reconciling three objectives: (1) to protect priority programs for economic and social development in order to enhance growth prospects and to mitigate the social costs of the economic crisis; (2) to exit from anti-crisis policies and ensure fiscal consolidation once the recovery is under way in order to make room for a private sector led recovery; and (3) to improve policies, regulations and coordination in order to prevent such crises in future. Further structural reforms can help to boost potential growth and facilitate the large fiscal consolidation (The World Bank, 2009a). The main challenges for fighting the economic crisis are to find the solutions aimed at gaining investors' and customers' trust and to stimulate investments in infrastructure.

3. The evolution of the Romanian public debt

Public debt is an important means of bridging government financing gaps. Effective and efficient use of public debt can increase economic growth and help a government to achieve its development and social objectives. However, public debt is also a doubled-edged weapon. Excessive reliance on public debt and inappropriate public debt management raise macroeconomic risks, hamper economic growth, and hinder economic development.

The debt management is closely related to the currency and budgetary policies. Therefore, the analysis of the government public debt portfolio must take into account the developments and macroeconomic estimates, the efficiency of the domestic capital market, and the worldwide economy evolution as well (Ministry of Public Finance, 2008b).

The above mentioned effects of the economic crisis have determined some specific evolutions of the public debt in Romania. According to data published by the Ministry of Public Finance (2009), Romania's total public debt rose 25.5% at the end of October 2009 as compared to the end of last year and reached RON 137.804 billion, representing 27.26% of the gross domestic product (GDP) estimated for the year 2009. At the end of 2008, the total public debt was of RON 109.75 billion and represented 21.78% of the GDP. Public debt accounts for less than 30% of GDP, well below the level set by Maastricht criteria, therefore we may assert that Romania's level of indebtedness is sustainable. The weight of the government public debt in the whole of the public debt increased by 0.99 percentage points versus the end of 2008, from 91.58% to 92.57%, while the local public debt stood for 7.43% of the total debt after the first ten months. The ratio of the negotiable debt rose to 36.8% at the end of October 2009, from 25.7% in December 2008, while the ratio of the non-negotiable debt decreased to 63.2% at the end of October 2009 from 74.3% at the end of December 2008.

The government public debt by type of holders at the end of October 2009 is shown in Figure 1.

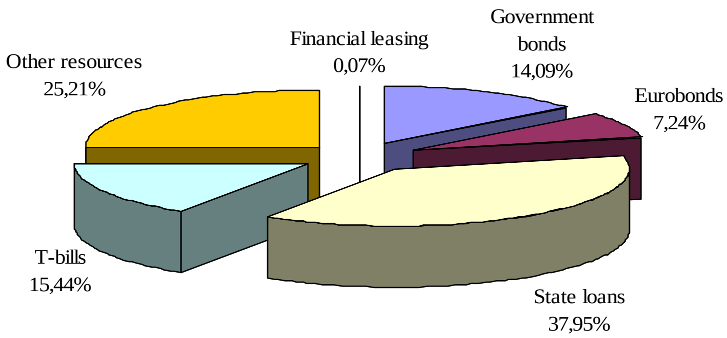

Figure 1 Government public debt by type of holders
(Source: Ministry of Public Finance, 2009)

The government public debt portfolio structure by type of holders at the end of October 2009 reveals that state loans accounts for an important share in total government public debt (37.95%), representing the main financing source for the budget deficit. Other resources (loans from the availabilities of the Treasury General Accounts) have also a significant share in total government public debt (25.21%), while T-bills and government bonds have a similar share (15.44%, and respective 14.09%).

The government public debt portfolio by currencies at the end of October 2009 (Figure 2) reveals that the debt in RON accounts for 51.73%, the debt in EURO for 35.92%, and the debt in USD, JPY and other currencies is below 7% each.

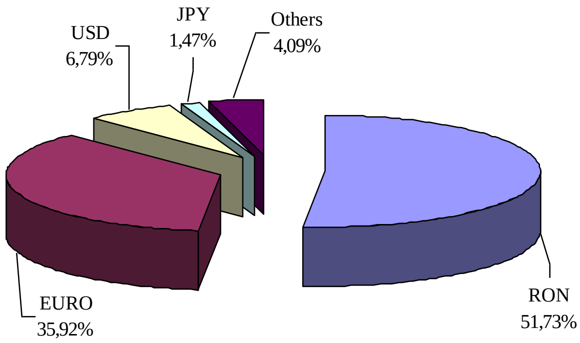

Figure 2 **Government public debt by currency**
(*Source:* Ministry of Public Finance, 2009)

The evolution of the external public government debt service for the time period of 2008-2010 is presented in Table 1 and illustrated in Figure 3.

The external public government debt service for 2008 was EUR 2309.7 mil of which EUR 1391.8 mil (60.26%) for external credits contracted directly by the state and EUR 917.9 mil (39.74%) for external credits guaranteed by the state. From this debt service EUR 1806.5 mil goes to amortization of capital and EUR 503.2 mil to the payment of interest and commissions.

External public government debt service

Table 1
EUR mil

	2008	2009	2010
External public government debt service, of which:	**2309,7**	**1519,2**	**2065,7**
- repayments	1806,5	1121,0	1705,1
- interest and commissions	503,2	398,2	360,6
1. External public direct government debt service, of which:	**1391,8**	**740,9**	**1450,2**
- repayments	1029,8	455,9	1178,8
- interest and commissions	362,0	285,0	271,4
2. External public guaranteed government debt service, of which:	**917,9**	**778,3**	**615,5**
- repayments	776,7	665,1	526,3
- interest and commissions	141,2	113,2	89,2

(*Source:* Ministry of Public Finance, 2008a)

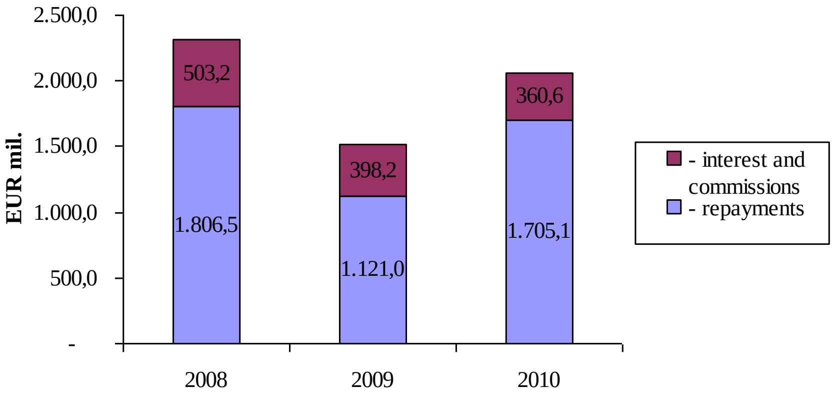

Figure 3 External public government debt service

The external public government debt service for 2009 is EUR 1519.2 mil of which EUR 740.9 mil (48.77%) for external credits contracted directly by the state and EUR 778.3 mil (51.23%) for external credits guaranteed by the state. From this debt service EUR 1121.0 mil goes to amortization of capital and EUR 398.2 mil to the payment of interest and commissions.

The external public government debt service for 2010 is EUR 2065.7 mil of which EUR 1450.2 mil (70.20%) for external credits contracted directly by the state and EUR 615.5 mil (29.80%) for external credits guaranteed by the state. From this debt service, EUR 1705.1 mil goes to amortization of capital and EUR 360.6 mil to the payment of interest and commissions. As strategy of external public debt a prudential commitment of this debt on medium term is recommended in order to avoid the bunching of the maturities in this period.

An important constituent of the government public debt management is the management of risk associated to the debt portfolio, which includes identification and assessment of risk, and hedging against different risk categories. The main risk types are: (1) the refinancing risk (the inability to refinance the debt or the refinancing at a very high cost); (2) the market risk, which includes currency risk (the increase of the foreign currency debt as a result of the depreciation of the domestic currency against the Euro and USD, where the state revenues are collected in the domestic currency) and the interest rate risk (higher interest rates on the domestic or foreign capital market); and (3) other risks, such as: the credit risk (bankruptcy of counterparts), the payment risk (errors in the payment system), the operational risk (errors in the debt management system or human error, lack of working procedures, lack of personnel), and legislative risk (interpretation of the law) (Ministry of Public Finance, 2008b).

The risk types mentioned above should be considered within the government public debt management. It is expected that the government public debt may increase in the near future in order to ensure the Romanian economy stability. While a policy mix is essential to maintain economic stability, increased attention could be paid to other needs, such as modernizing Romania's infrastructure. In this respect, public debt indicators show that there is enough room for new foreign financing to be devoted to infrastructure development.

4. Conclusions

This study has revealed that Romania's public debt can be considered sustainable so far. Despite the strong impact of the worldwide economic crisis on the Romanian economy, the level of indebtedness is below the one set by Maastricht criteria.

Another conclusion of this study is that the Government of Romania may use new foreign financing for infrastructure development, as a solution for economic recovery. This conclusion is based on the premise that effective and efficient use of public debt can increase economic growth and help a government to achieve its development and social objectives. However, there are important risks associated to the debt portfolio, which the government should take into account when raising the level of indebtedness through new foreign financing.

This study provides a rational background for finding solutions to the problems encountered by the Government of Romania in order not only to surmount the economic crisis, but to upturn the international investments in Romanian infrastructure. The findings of this study may be used as a starting point for policy making in the fields of public investments and government public debt management.

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