Public Debt Policy in Romania – A Critical Review

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Abstract: Public debt policy must be anchored in both the socio-economic background in which it is promoted and the medium and long-term development strategies reflected in promoted macroeconomic policies. Under the impact of some pressure factors (changes of the political regime, socio-economic system or the economic crisis) indebtedness decisions may often be taken ad-hoc, lacking vision and thus creating a major threat to medium and long-term development. From this perspective our work aims, by analyzing Romanian indebtedness data (1990-2011), to identify the main coordinates of public debt policy, focusing on highlighting the poor approaches, their causes and implications, by reference to already validated scientific conclusions. The analysis is detailed over three periods of time differing in economic background and applicable legal regulations, the general conclusion of the study reflecting the lack of a coherent and effective debt policy, with unfavourable implications over the long-term development of our economy.

Key-Words: public debt policy, general government, transition, social and economic development

1 Introduction

Our approach starts from the premise that public indebtedness should not translate ad hoc discretionary decisions, adopted in the absence of a long-term vision that takes into account debt's effects, but should result as a unitary whole correlated with a number of objectives and specific instruments (public indebtedness policy). Starting from this premise, our paper seeks to answer the following questions:

- What were the main coordinates of Romanian public debt policy conducted after 1990?
- Whether there was in Romania, in certain periods of time, a predominant form of public debt?
- How can it be explained the authorities' "preference" for certain public debt instruments or forms and what are its implications?
- How can Romania's past indebtedness behaviour affect its near or distant future, taking into account the current realities?
- Can it be supported the claim that Romania had a coherent debt policy between 1990 and 2011 and what reconsiderations would be required on the background of the new global economic conditions?
- How realistic is the widespread opinion that Romania is in a comfortable situation in terms of its public indebtedness?

To answer these questions, our work proposes a empirical analysis of Romania's public debt during 1990-2011, by calculating well-known indicators of global debt as support for making empirical observations. The data we used in our analysis, covering the entire period of time, come mainly from reports of the Romanian Ministry of Finance as well as yearbooks, reports or databases of the Romanian National Institute of Statistics, the Romanian National Prognosis Commission and Eurostat.

2 State of knowledge

Regarding the current state of knowledge, the issues we assumed to clarify have naturally been mostly the object of autochthonous research but there are no studies devoted to the analysis of debt policy. However, related issues are addressed in the works of some autochthones authors: [8], [12], [13], [18] and [19]. The key findings relevant to our study concern the characteristics and effects of the debt policy promoted in only a certain period of time (1990-2000), being to note that the commitments were sometimes contrary to even the interests of our country. Studies exploring the dimensions of Romanian public debt do not provide a true image for the entire period (1990-2011), either because the approaches are global (without invoking the forms of debt) or because they concern only certain years [5]. A more abundant literature is that adjacent to our study, treating the issue of Romanian public or external debt sustainability [2], [3] and [20].

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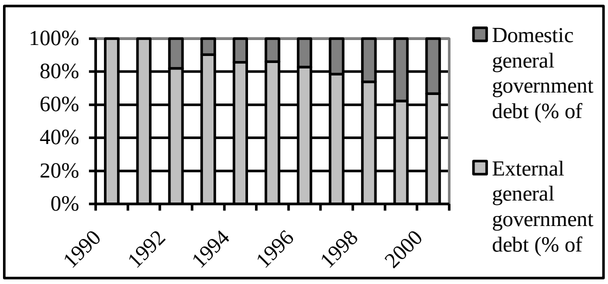
At international level, although the literature is abundant, we cannot identify studies that distinctively and thoroughly involve the case of Romania, most of approaches emphasizing the particularities of some homogeneous or regional groups, in which Romania could be included, such as emerging markets, new EU member states, Central and Eastern European countries [1], [15] and [17]. However, because of the basis of their formulation, the conclusions of such studies cannot be automatically and entirely validated for the particular case of Romania. The issue of public debt is constantly the subject of studies or periodical reports of specialized institutions, but they do not propose and do not validate scientific findings, the typical content rather being one of descriptive nature [6] and [7].

3 Coordinates and implications of Romanian public debt policy between 1990 and 2000

At the beginning of 1990s, our country was marked by the absence of public debt legislation; the first law of the transition trying to define the terms and conditions under which the state could borrow coming into force only in late 1993. Also, the period between 1990 and 2000 was an extremely difficult and tumultuous one for our country. On this background, public debt as a share of GDP has generally recorded, with some exceptions, an upward trend, increasing from 0.9% in 1990 to a maximum of 33.2% in 1999. Although the objective causality of public indebtedness cannot be contested, resulting from budgetary imbalances fuelled mainly by structural economic weaknesses, we must note that resorting to extraordinary resources and their use should have been adequately accompanied by rapid and deep reforms, especially when it came to resizing the state economic sector. The use of debt resources mainly to finance current needs, on the background of delaying various reforms, actually conducted to an inadmissible extension of the life of unsustainable public economic entities, for which subsidizing meant in reality the coverage of losses [4].

On such a background and in correlation with a domestic capital market insufficiently developed and therefore unable to meet both the needs of the private and public sectors, public authorities' debt policy has most often been oriented, in terms of the borrowing sources, similarly to other developing countries, towards raising loan resources from abroad, which is reflected by an external public debt to domestic public debt ratio higher than one (fig. 1).



Source: [9] and authors' calculations

Fig. 1 The proportions of domestic and external public debt (1990-2000)

As a public debt policy's coordinate before 1996, we can notice that in order to finance budget deficits and cover other financing needs, Romanian public authorities have mainly resorted to foreign loans, therefore foreign debt permanently representing over 80% of the general government debt. Later on, as the ratings assigned to our country by international specialized agencies fell, resulting in limiting Romania's access to external financing, and as the legal framework regulating the instruments of domestic public indebtedness emerged, public authorities turned, to an increasing extent, to domestic resources. In this context, domestic public debt rose steadily until 1999, when it reached 37.8% of the overall public debt; however, its size still remained much lower than the external public debt's one.

The prevalence of external borrowing, over this period, can be assigned both to the actual ability and the opportunity of borrowing on domestic market. Thus, on one hand, public authorities' ability to borrow on domestic market was generally low over this time, as a result of the insufficient development of the domestic debt market, the dysfunctions of the economy, the lack of a competitive market and the distrust in our national currency, subject to sharp and continuous depreciations. On the other hand, the orientation towards foreign markets was also justified by the lower costs of financing as well as by the permanent need to raise foreign currency resources, indispensable for financing the balance of payments deficits. From another perspective, however, foreign currency borrowing claimed for important foreign currency resources to be available to honour external debt's service, later on, when loans reached maturity. With reference to public authorities' domestic indebtedness, one can notice that between 1992 and 2000 it mainly occurred in correspondence with the banking sector, besides the sole holder of domestic public debt securities until

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1998. Although the general socio-economic context can be considered a consistent explanatory factor for this "preference" of Romanian public authorities, in our opinion such a policy had many drawbacks, making its contribution, on the background of an imperfect legal framework, to the proliferation of inflation and negatively affecting banks' lending to the real economy.

Another coordinate of Romanian debt policy, characteristic for the period 1990-2000, is the overwhelming share of debt to international financial institutions. This option proved to be advantageous in several respects, including more favourable borrowing terms (interests, grace periods, maturities, repayment schedules). At the same time, such a policy increased our country's dependence on outside groups, as Romanian authorities had to implement the reform programs agreed upon with international institutions, programs that, according to some experts, were not the most appropriate for our country. It should have been noted from this experience, as an important lesson to remember, that the lack of a consistent concern for budgetary consolidation may lead in the future, when debt financing requirements are high, to the weakening of the state's autonomous decisional (economic and social) position and public authorities will effectively have to comply with their creditors' conditions, sometimes hard to accept. Unfortunately, such situations have vanished away from public memory during the period of consistent economic growth between 2004 and 2007, when public authorities pursued a pro-cyclical fiscal policy, despite the opposite scientific conclusions, consistently affecting Romania's fiscal stance and had, in 2009, to once more accept the difficult conditions imposed for raising debt resources.

4 Romanian public debt policy between 2001 and 2007

From an economic perspective, the period 2001 - 2007 is known in the post-revolutionary history of our country as a very favourable one, marked by high GDP growth rates (exceeding even, in real figures, 8% of GDP in 2004).However, even then Romanian public authorities continued to promote significant budget deficits, although substantially reduced compared to the previous period (the average general government deficit was, over this period, of 2.1% of GDP). Against this background, although public debt rose in nominal figures, its trend as a share of GDP generally was descendent, thus confirming the developments already anticipated at the end of 2000. Public debt to GDP ratio fell from 28.7% in 2001 to 18.4% in 2006, a value that has not been recorded since 1994. These circumstances, along with the high (although artificial) economic growth, fuelled the emotional reactions of public policy makers who initiated or accepted substantial increases in public liabilities, especially social ones, thus inducing increased budgetary vulnerability, well evidenced by the strong economic contraction that began in late 2008. In 2007, public debt already resumed its previous upward trend, increasing up to 20.5% of GDP. The progress in reducing public debt ratio registered over this period (the energy of which should, by the way, have been preserved) can be considered especially important as, since 2001, on the background of the emergence of an adequate legal framework for local governments' indebtedness, they began to raise loan resources (resulting from bank credits or municipal bonds issuing) at a greater extent, and local government debt became a stand-alone component, with some relevance in the general government debt.

The improved credit ratings assigned to our country by specialized international agencies after 1999-2000, as well as the favourable conditions on foreign markets, led to the reorientation of public authorities' debt policy towards external borrowing, after its decline in 1999. Against this background, external public debt increased during 2001-2003, from 72.4% to 77.3% of the overall public debt, while domestic public debt decreased. Subsequently the trend reversed and the ratio of domestic to external public debt became, for the first time in our post-revolutionary history, higher than one at the end of 2007. This situation reveals yet another coordinate of Romania's debt policy, characterized by the improvements in our public authorities' ability to borrow on the domestic capital market and the diversification of debt instruments (such as the issuing of CPI-indexed bonds).

The structure of external public debt by creditors shows that the trend of increasing private sources financing (from foreign private banks or investors on international capital markets) continued, while the share of debt resulting from multilateral loans and loans from foreign governments fell. If in 2001 the latter represented 59.9% of the overall external public debt, it gradually decreased to 46.8% in 2007. As for the direct domestic debt, banking sector's share continued its decreasing trend, but mainly due to the use, to a larger extent, of resources from the general current account of State Treasury.

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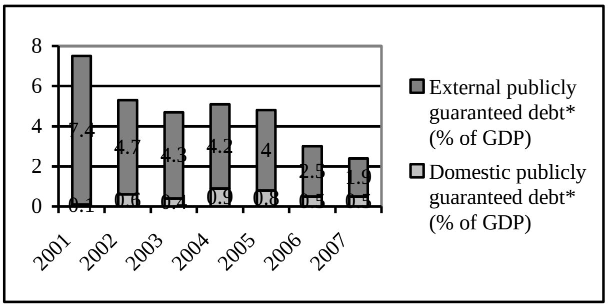
The predominant orientation towards the domestic market, after 2004, at the expense of Eurobond issuance and financing from international financial institutions, as well as the frequent use of temporary funding from the general current account of state treasury led to some changes in debt structure. A direct effect was reducing its maturity, by increasing the share of the short-term component and decreasing that of the long-term one, which led to increasing refinancing risk. At the end of 2007, short-term debt represented 41.9% of general government debt, compared to only 20.8% at the end of 2002. At the same time, however, the share of foreign currency debt decreased, leading to the reduction of the exposure of public debt portfolio to foreign currency risk. If at the end of 2002 it represented 79.13% of general government debt, it reduced to only 46.81% at the end of 2007 [11].

The indebtedness of central public authorities on domestic markets mainly concerned, between 2001 and 2007, the financing of annual budget deficits. On the basis of special laws government bonds were issued over this period for completing the privatization of the Agricultural Bank and the restructuring of Bancorex. Under these circumstances, the ratio of domestic public debt contracted on the basis of special laws to overall domestic public debt progressively reduced from 17.9% in 2001 to the insignificant value of 0.08% in 2006. Similarly, the share of external public debt for financing the balance of payments and for consolidating foreign currency reserves continued its downward trend, while the share of external public debt for economic projects increased.



*data refer to general government debt

Source: [11], [16] and authors' calculations

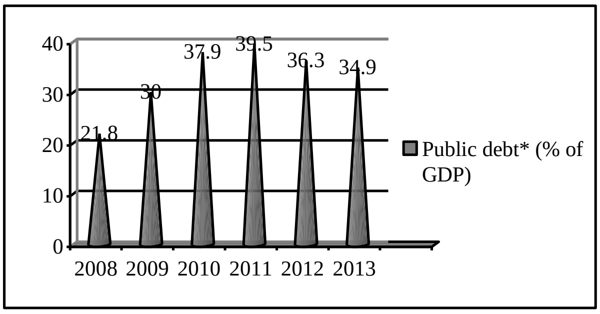
Fig, 2: Domestic and external publicly guaranteed debt (2001-2007)

With regard to the guarantees granted on different public or private entities' loans, we can notice (fig. 2) a downward trend of their share in GDP from 7.5% in 2001 to only 2.4% in 2007, which further indicates the reducing of state involvement in supporting the private sector, due, among other things, to the more favourable economic conditions. It is relevant in this respect that public authorities granted, in 2007, only one guarantee, namely for the domestic loan contracted by Electrocentrale Bucuresti.

5 Coordinates and implications of Romanian public debt policy after 2008

The separate analysis of public authorities' debt policy since 2008 is justified both by the amendments to public debt's legal framework in force over this period and, especially, by the manifestation at this stage of the effects of the international economic and financial crisis which, coupled with some already existing internal problems, affected quite strongly our country too.

With reference to the legal framework, once our country joined the European Union in 2007, the legal framework on public debt underwent some changes in order to adapt to European practices. On the wider financial plan, the manifestation of the global economic crisis's effects led to a significant degradation of the general government balance (according to EU methodology, the general government deficit was 8.5% of GDP in 2009 and Romania was put under the excessive deficit procedure) and, therefore, increased public financing requirements, which further led to the resumption of the upward public debt trend. As can be seen from the data reflected in fig. 3, it increased from 21.8% in 2008 to 30% of GDP in 2009 and 37.9% of GDP in 2010.



* Data refer to general government debt; data are estimated for 2010 and forecasted for 2011-2013

Source: realized by the authors on the basis of data from [9] and [10]

Fig. 3: The dynamics of public debt as % of GDP (2008-2013)

On the background of diminished access to international financial markets and of the instability that dominated the global financial system in 2008-2009, Romanian public authorities were forced to resort, to a greater extent, to domestic loan resources. The Ministry of Finance successfully launched, on the domestic debt market, 24 issues of government securities in 2008 and 33 in 2009. Thus, the share of domestic public debt continued its rising trend, reaching about 62% of the overall public debt at the end of 2009.

The diminished access to financial markets as well as the high quantity of financial resources that had to be borrowed, forced once again Romanian authorities to resort to IMF and other international bodies' resources. Such an option appeared to be more advantageous both in terms of lower costs and longer maturities. Thus, in April 2009 Romania concluded a two years agreement for a package of external financing worth 19.95 billion euro, out of which 12.95 billion from the IMF, 5 billion from the European Commission, 1 billion from the World Bank and 1 billion from EBRD-EIB-International Finance Corporation. Much of these resources were used to finance budget deficits, others to consolidate foreign currency reserves and support for development policies.

The international financial and economic crisis has also left its marks on the access to finance of agents implementing projects of strategic interest, with multiplication effect in our national economy. In this regard, although in 2008 there weren't issued any state guarantees, in 2009-2010 public authorities resumed their support programs by using state guarantees. Thus, the share of publicly guaranteed debt increased from 1.6% of GDP in 2008 to 2.9% in 2010. Supporting for private or local governments development plans by providing governmental guarantees, should be a priority in current conditions, thus creating favourable premises for resuming and maintaining the upward economic trend [14].

6 Conclusions

The general conclusion resulting from our analysis is that Romania did not have, over the period 1990-2011, a coherent debt policy, consistent with the development needs and the potential of our country. One element of major importance to assess the efficiency of public debt policy must be represented by its effects on socio-economic development, in accordance with borrowed resources' destinations, which should always be subordinated to the imperative of creating added value in the economy and society. Although the complexity of our research subject did not allow for a thorough analysis of this issue over the present study, we can support the conclusion that in Romania, over the period of our analysis, indebtedness was not conveniently oriented (consumption expenditures were financed with priority), in contradiction with already validated scientific conclusions.

Our study confirms for Romania the typical behaviour of emerging markets, public authorities being forced to borrow either for a longer term but in foreign currency or, respectively, in national currency, on the domestic debt market, but for short time ("original sin"). Such a debt policy increased the vulnerability of the Romanian economy by exposure to additional risks (such as the foreign currency risk or liquidity risk). From this perspective, providing a fertile ground for conducting a sound debt policy requires a greater concern of public authorities towards the development of the domestic capital market, thus reducing the dependence on external financing, associated with potential conditions sometimes hard to accept by authorities or citizens. At the same time, the indebtedness of public authorities preponderantly to banks, during 1992-2000, was one of the factors contributing to the proliferation of inflation, as the express prohibition of budget deficits financing by borrowing from the central bank was legalized quite later in time.

Another objectionable matter is that Romanian authorities agreed to take over to public debt the liabilities of non-performing economic agents, while reservations were expressed when it came to granting guarantees to obviously viable enterprises. Thus, favourable premises have been created for public indebtedness to act as a hindering factor for stabilization and growth, instead of an accelerating one, the problems of 1999 being especially relevant in this respect. This flawed approach correlates with Romanian authorities' reluctance in granting guarantees for supporting viable development plans and with their preference for public entities, the competitive climate being far from stimulated.

The above "lessons" should undoubtedly be taken into consideration when designing and conducting state's debt policy, but Romanian officials' positions did not confirm this in full lately. Thus, the increase in Romania's public debt from 21.8% of GDP in 2008 to the forecasted share of 39.5% of GDP at the end of 2011 (almost the double of the initial value) must be interpreted as a net deterioration of Romania's position, as serious signs of recovery (e.g. forecasted GDP growth) are not confirmed yet. The effective capacity to support for debt repayments should not be judged against today's potential, but against the one forecasted at debt's maturity, or global phenomena with negative impact (especially the aging of population) strengthen the negative perspective. However, paradoxically, it can be easily observed the relaxed attitude of public decision makers who plead in their public discourses for the comfortable position resulting from Romania's current debt level by reference to the maximum 60% of GDP threshold, although it is scientifically confirmed that developing countries face greater difficulties and at lower amounts of debt than the developed ones, when it comes to their ability to honour their commitments. On this basis, we subscribe to the idea that the main concern should not be to identify new ways of financing rising public expenditures, but to rationalize and redesign them as economic and financial levers counting for the development of the economy.

In light of this study's results, it is first necessary to reconsider public authorities' attitude when it comes to debt policy, which should gain more attention in times of prosperity, not only during recessions. For these difficult times, rationalizing public spending and supporting development by granting government guarantees for development plans that involve resources from European funds could prove to be serious alternatives.

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