TREND AND CHARACTERISTICS OF PUBLIC AND PRIVATE FOREIGN DEBT IN ROMANIA

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Abstract: *In the article, the authors analyse the evolution of long-term private and public external debt in Romania in the period 2008-2022, as well as the evolution of related services, highlighting some of their characteristics, especially from the point of view of costs. The research shows that although medium and long-term public external debt increases almost continuously during the analysed period, while medium and long-term private external debt fluctuates, the costs are higher in the case of medium and long-term private external debt. Thus, the private external debt service in the medium and long term is higher than the public external debt service in the medium and long term, a situation generated by better loan conditions in the case of public external debt. The authors also show that the medium and long-term external public debt, respectively the related service, has deeper annual fluctuations compared to the medium and long-term external private debt. The methodology used combines the empirical analysis of statistical data and their interpretation, with the identification of causalities.*

Keywords *: foreign loans, external debt service, causes, evolution, risk, costs.*
JEL Classification: *F34, H63.*

1. Introduction

Contracting external loans allows the debtor country to make a higher volume of investments than it would be possible using only domestic resources, from savings or credits. Also, *the external debt supports the internal demand* of the country that receives the loans and it represents *a source of financing the temporary deficits of the balance of payments*. If the balance of payments’ deficit is permanent, long-term financing through external borrowing may delay the economic adjustments necessary to offset it, and it may worsen the fundamental problems of the balance of payments.

The external debt service includes all external payments (capital rates, interest and commissions) derived from foreign debt, during a year. When it reaches *a significant amount, the debt service raises two problems for the indebted country*: on the one hand, there is the need to earn or save the foreign currency necessary for its payment, and on the other hand, there is the problem of public financing, which entails the generation of budget revenues, in local currency, equivalent to the external payment duties. That is why governments are interested in their own payment obligations, related to the external debt, which affect both budgets and foreign exchange reserves of the countries. Also, governments can be involved in providing foreign exchange to cover payment obligations for the service of the private sector's commercial debt.

The most important issue about debt in general is ensuring its sustainability.

The authors define *debt sustainability* as a property that makes the evolution of the debt to ensure the payment of the debt service in the medium, and possibly long term, without the need for significant changes in the economic policies, without generating shocks and/or tensions on the domestic market, without inducing major fluctuations of some macroeconomic variables of the national economy. Sustainability allows fluctuations in the debt, being important to obtain the expected, positive effect in the medium and long term. Milea (2019)

Long-term debt sustainability is a dynamic concept, which depends not only on the debt stock and its associated service, but also on the growth rate of new loans, on the evolution of the fiscal situation, on the debt profile, on the effects of debt in the economy, on the behaviour-answer of the economic agents, on the financial flows that a country can absorb effectively, and their yield, on the volume of foreign exchange reserves, etc. Thus, debt is not sustainable if the borrowing country accumulates debt at a faster rate than the increase of its ability to pay debt service, especially over the long term.

From the definitions existing in the debt sustainability literature, a criterion of debt sustainability emerges, namely the borrowed capitals must be used for investments with a yield at least equal to the interest rate paid on the contracted debt, or for the implementation of economic reforms.

We can describe an *"almost risk-free country"* by several economic characteristics: a small ratio of foreign debt to the ability to pay (GDP or/and exports), low share of short-term debt in foreign exchange reserves, low value of external public debt in tax revenues, and an exchange rate of the national currency that is not excessively overvalued (Manasse P., Roubini N., 2005).

In the context of the restrictive measures adopted by the government to combat the pandemic, state aid has been greatly increased, which has led to a significant rise in public debt in recent years.

Currently, Romania is facing a situation of uncertainty and risk, with a war at the border, the reorientation of commercial and capital flows, political and legislative changes, which rather stimulate savings and the postponement of investments by companies.

In the article, we will analyse public and private external debt, and the characteristics of their evolution, highlighting some causes that induced their trend.

2. Characteristics of the public and private foreign debt of Romania in the period 2008-2022

Total medium and long-term external debt has increased between 2009 and 2022, except for the period 2013-2018.

The medium and long-term foreign public debt has increased almost continuously during the analysed period (except for the years 2015 and 2022), in 2020 being the most important annual growth of the analysed period (see figure no. 1).

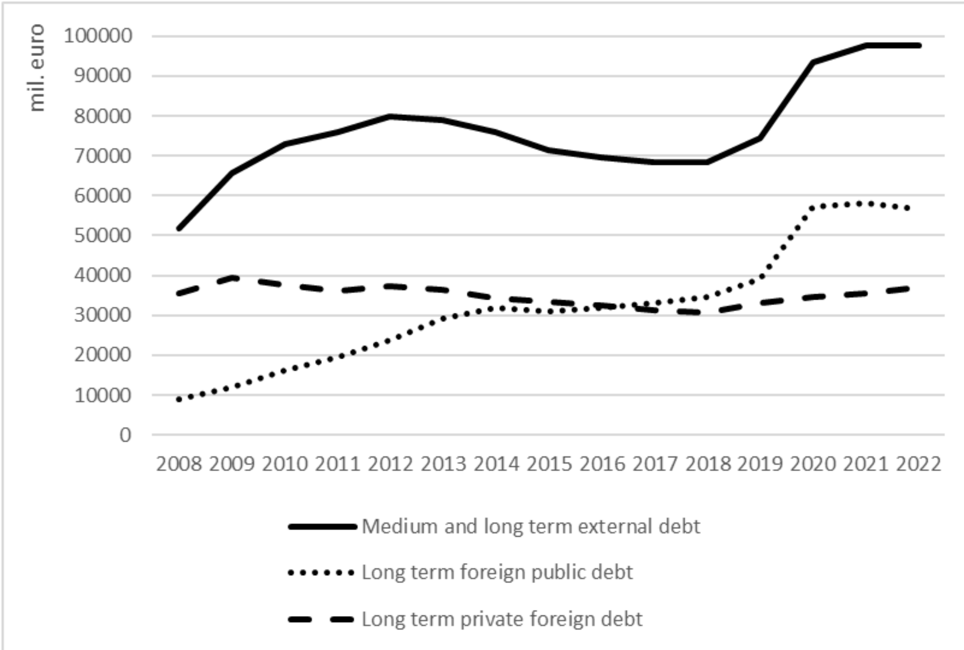

Figure no. 1 – The trend of long term public and private foreign debt in Romania
Source: NBR data and authors' calculations

The increase in the public debt in 2020 was generated, on the one hand, by the rise in public spending aimed at first to limit the spread of covid-19 and to treat the sick people (including purchases of health products), and a few months later to support the economy, respectively to counteract the economic effects caused by the first measures, including the decrease in income, the economic contraction, the loss of jobs. On the other hand, it was due to the expansionary measures adopted before the pandemic: the increase of pensions and other social expenses, the reduction or elimination of some taxes and fees, the decrease of some social contributions, etc.

The level of the budget deficit is one of the most important causes of the increase in external public debt. The budget deficit was in a process of consolidation, since 2013 until 2016, when significant progress in its adjustment was made. Starting from 2017, the budget balance has deteriorated continuously, the situation getting worse in 2020, both due to the inertia of expenses growth measures from previous years, as well as a result of the increase in administrative expenses in the context of the unfavourable evolution of the pandemic and its socio-economic consequences. Thus, the budget deficit has increased, both in absolute value and as a share of GDP (9.5% in 2020, respectively 6.8% in 2021, from 4.5% in 2019).

The budget deficit and the negative goods balance make it necessary to resort to external loans in the next period as well.

The medium and long-term external private debt decreased almost continuously between 2010 and 2018, and has increased between 2019 and 2022. As of 2017, medium and long-term external public debt is higher than foreign private debt (see figure 1).

In the period 2009-2020, medium and long-term public external debt had a higher annual growth rate compared to private debt (with the exception of 2015, when both types of external debt decreased, public debt at a slightly higher rate). In the year 2020, there was the highest annual increase in long-term external public debt, the borrowed capitals being necessary to support the economy, as well as natural and legal persons affected by the measures adopted by the authorities at national and international level to prevent the spread of the coronavirus. We can say that the external shocks (the economic-financial crisis of 2008 and the medical crisis of 2020-2022 had deeply negative consequences on the Romanian economy.

In most of the years of this period (except 2015), external public debt increased, while external private debt decreased (except for 2009, 2012 and 2019-2022). Between 2019 and 2022, external private debt has grown, in the last 2 years having a higher annual rate than that of medium and long-term external public debt (see figure no. 2).

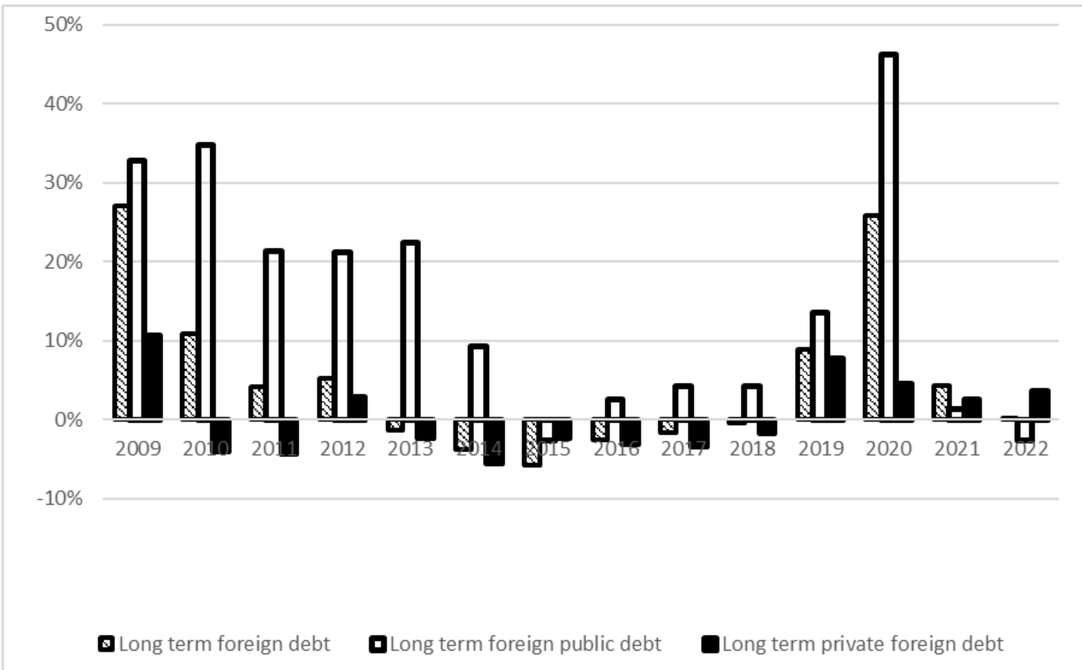

Figure no. 2 – The trend of long-term public and private foreign debt in Romania (annual rate)

Source : NBR data and authors' calculations

It is noticed that the external public debt in the medium and long term has steeper annual fluctuations compared to the external private debt in the medium and long term.

Analysing figure no. 3, we find that during the period 2008-2016, the share of external private debt in GDP is higher than that of external public debt in GDP. Starting from 2013, the indicator related to private debt decreases, peaking at around 15% in the period 2017-2022. The share of external public debt to GDP fluctuates more, with growth between 2008 and 2014, followed by decrease until 2018, an increase in 2020 and slight reduction in 2021 and 2022. Between 2017 and 2022, the share of external private debt to GDP is lower than that of the external public debt in GDP.

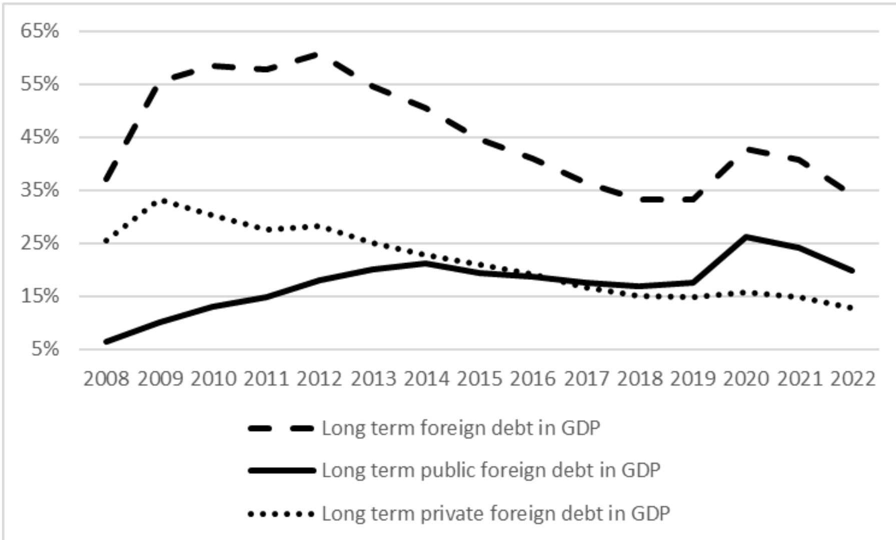

Figure no. 3 – Long term private and public external debt as a share of GDP in Romania

Source: NBR data and authors' calculations

Even if, at the level of the European Union, Romania is among the countries with public debt relative to GDP below 60% and with a relatively small external debt relative to GDP, the constant, repeated resort to foreign loans will cause these indicators to deteriorate. Already according to the trend of the last years of the total external debt in GDP (increase from 49% in 2019 to 58% in 2020), we can assume that, in the medium term, Romania will exceed the 60% threshold imposed by the Maastricht Treaty, through the convergence criteria for joining the Euro area. In 2022, the average interest rate at which Romania has borrowed on foreign markets is around 9%, the highest from all European Union countries. High interest rates can become burdensome, to the point where newly contracted loans are used only to roll over older debts with unsustainable interest rates at a certain level of economic development.

The evolution of the share of total external debt in GDP is positive in 2021 and 2022 as it drops to 50%.

The share of medium and long-term external public debt in the total medium and long-term external debt had risen during 2008-2020, and has decreased slightly in 2021 and 2022. The share of medium and long-term private external debt in the total medium and long-term external debt has decreased discontinuously in the analysed period. The public debt indicator is higher than that of the private debt indicator starting with 2017 (see figure no. 4).

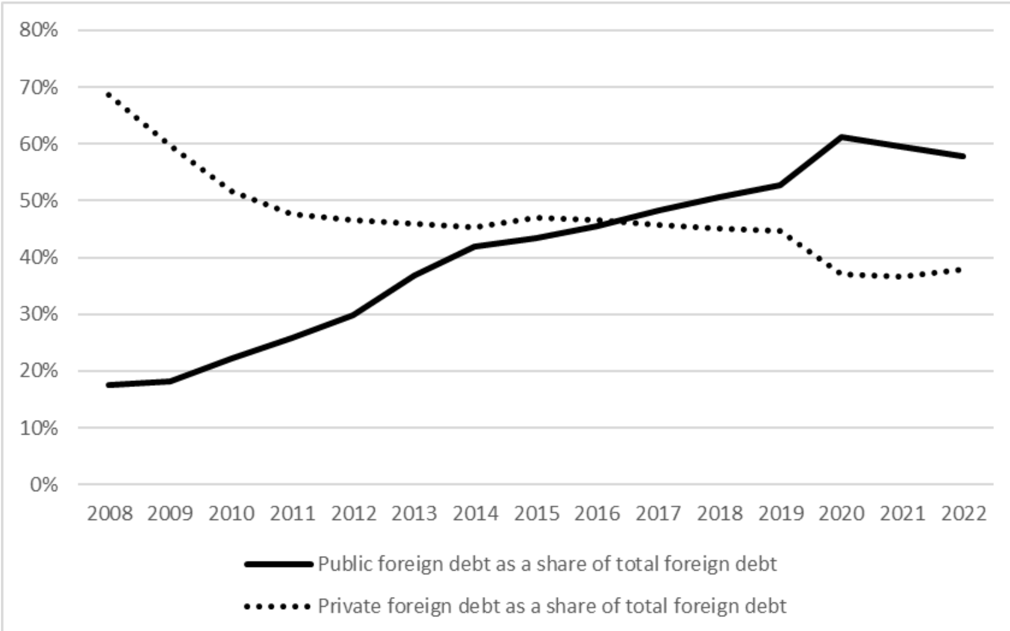

Figure no. 4 – The public and private external debt as a share of the total long term external debt in Romania

Source : NBR data and authors' calculations

Throughout the analysed period, it takes place the consolidation of international reserves and the harmonization of their currency structure (euro 55.6%, USD 19.6%, in 2021) with that of the medium and long-term foreign debt (73% euro , 13.5% RON, 9% USD), and with that of the medium and long-term foreign debt service. The high level of international reserves indicates a low liquidity risk.

The evolution of Romania's international reserves shows our country's solidity and credibility from a financial-banking point of view, and it supports the sustainability of the Romanian economy.

3. Characteristics of the service of the public and private foreign debt of Romania in the period 2008-2022

The debt service represents the amount that must be paid in the respective year on account of the debt borrowed in the previous years, and it consists of the principal (a part of the amount borrowed, which must be repaid to the creditor in the respective year), and the related interest and the commissions (the cost of the debt).

The service of the medium and long-term external debt fluctuates throughout the entire analysed period, rising in some years (2010-2013, 2015 and 2022) and decreasing in the others.

The service of the medium and long-term external private debt is higher than that of the medium and long-term external public debt. Considering the evolution of the two types of debt and their related services, we can say *that private external loans are obtained under harsher credit conditions* (interest rate, commissions, total cost, return period, repayment scheme, grace period*) than external public loans* (see figure 5).

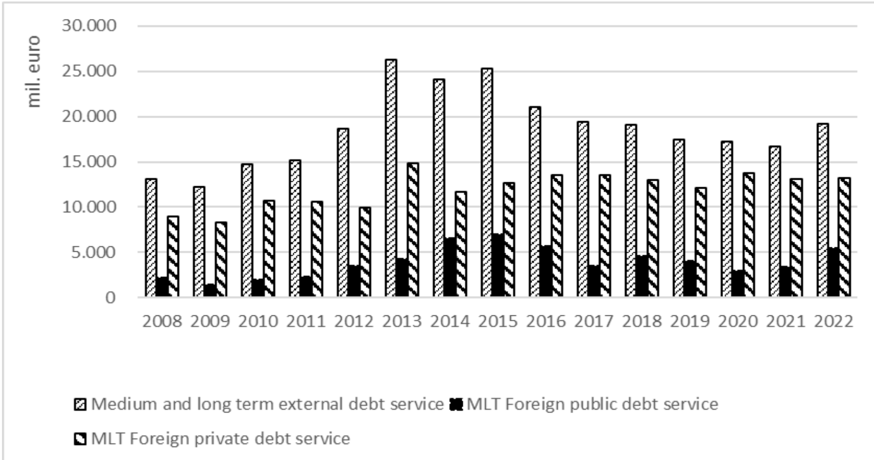

Figure no. 5 – The trend of long-term public and private foreign debt service in Romania

Source: NBR data and authors' calculations

The medium and long-term external debt service has had a fluctuating evolution, with increases and decreases from year to year, both for private and public debt. In the analysed period, the years 2010, 2012, 2014, 2018 and 2022 stand out with significant annual increases in the case of medium and long-term external public debt service (2022 being the year with the most important increase). These developments are explained, in part, by the loans contracted by Romania to fight the effects of the economic-financial crisis in 2009, of the covid-19 pandemic and of the measures adopted by the authorities to prevent the spread of this virus in 2020 and 2021 (see figure no. 6).

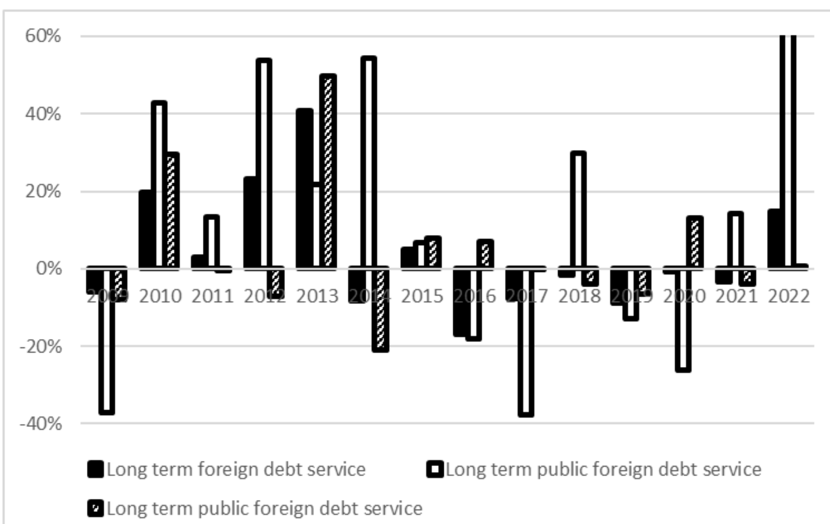

Figure no. 6 – The trend of long-term public and private foreign debt service in Romania (annual rate)

Source : NBR data and authors' calculations

The service of the private external debt shows the largest increases in 2010 and 2013.

It is noticed that the service of the external public debt in the medium and long term has higher annual fluctuations compared to the service of the external private debt in the medium and long term.

Throughout the entire analysed period, the service of private external debt as a share in GDP is higher than that of public external debt in GDP (see figure 7). The evolution of this indicator shows a better schedule of maturities, or longer payment dates in the case of public external debt (hence better loan conditions), considering that starting from 2017, public external debt is higher than private external debt, the increase in the public foreign debt being significant in 2020.

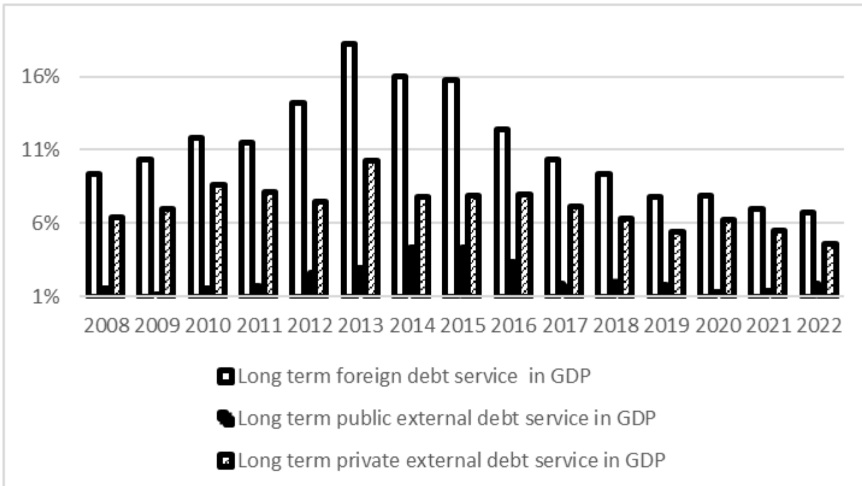

Figure no. 7 – The service of the long term private and public external debt as a share of GDP in Romania

Source : NBR data and authors' calculations

Also from figure no. 8, we can see that, in Romania, private external debt has a higher cost compared to public debt.

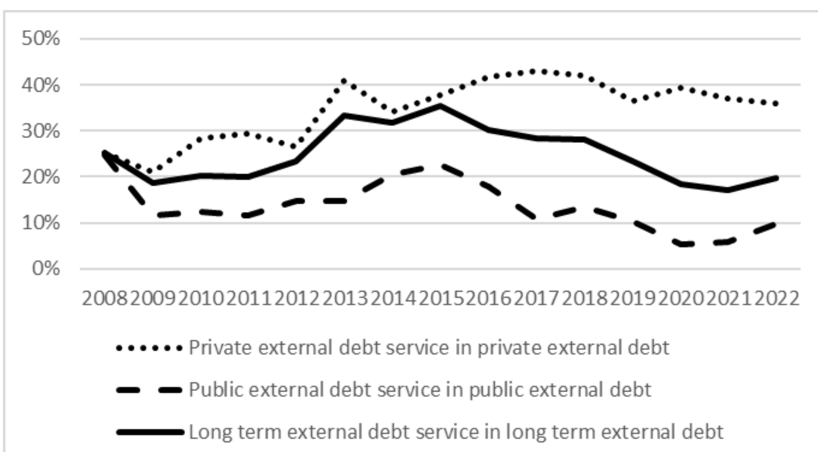

Figure no. 8 – The service of the long term private and public external debt as a share of the private and public external debt in Romania

Source : NBR data and authors' calculations

The share of private external debt service in the total service of the medium and long-term external debt is higher than the same indicator related to public external debt throughout the period 2008-2022. The values recorded by both indicators do not have constant evolutions, fluctuating (see figure no. 9).

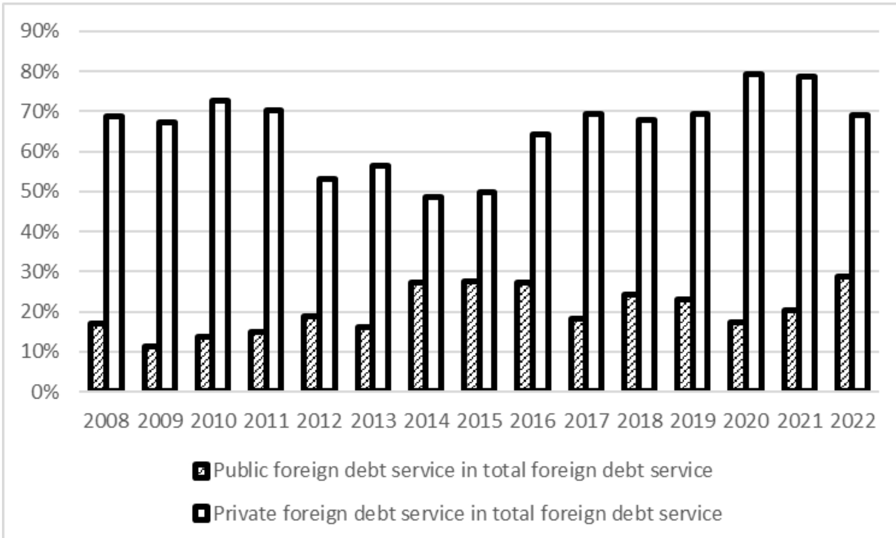

Figure no. 9 – The public and private external debt service as a share of the total long term external debt service in Romania

Source : NBR data and authors' calculations

One of the most important current and prospective risks is the boost in the cost of debt service. This is due to the high level of debt (especially public debt), corroborated with the trend of accrual in interest rates at the international level, given that central banks around the world have raised interest rates over the past year in an attempt to control high inflation. Under these conditions there are concerns about the leverage effect in the financial system.

4. Conclusions

In most years of the analysed period, medium and long-term external public debt had a higher annual growth rate compared to external private debt.

The year 2020 has witnessed the largest annual increase in long-term external public debt since 2009, the borrowed capital being necessary to support the economy, and natural and legal persons affected by the measures adopted by the authorities at national and international level in order to prevent the spread of the coronavirus.

Although, in Romania, public debt is below the level established by the Maastricht criterion, its evolution in recent years requires the adoption of measures meant to temper its growth, considering that *the dangers of excessive growth of public debt exist and should not be ignored.*

The fact that public debt creates intergenerational inequity must also be taken into account. Because high public debt means that the current generation spends more than it produces, shifting the burden of bearing the cost of this higher standard of living onto future generations.

Traditionally, public debt management should focus on achieving a trade-off between, on the one hand, minimizing the cost involved in issuing government securities (which is usually lower in the case of short-term securities), and on the other hand, minimizing the risk related to the public debt profile of the respective country (which, as a rule, is lower in the case of long-term securities) (Cerna, 2019).

It is found that the external public debt in the medium and long term, respectively the related service has larger annual fluctuations compared to the external private debt in the medium and long term and its service.

The trend of the analysed indicators shows a better schedule of maturities, longer payment dates, smaller costs in the case of public external debt (hence better loan conditions). Thus, we can say that, *in Romania, private external loans are obtained under harsher credit conditions than external public loans*.

One of the most important current and prospective risks is the accrual in the cost of debt service. This is due to the high level of debt (especially public debt), corroborated with the trend of increasing interest rates, given that central banks around the world have raised interest rates over the past year in an attempt to control high inflation.

We might say that Romania should not be worried about the absolute or relative value of its public debt, but about the country's ability to pay its loans. Thus, debt sustainability does not require only maintaining the indicator below a certain critical level, but also ensuring that additional indebtedness has its counterpart in assets or structural changes in the economy, which would allow the payment of debts in the future, without high sacrifices for future generations.

The experience of the shock caused by the covid-19 pandemic shows that there are totally unknown, unanticipated events that can deeply affect the national economy and the world economy, and that the economic prospects can suddenly worsen, therefore a mix of policies is necessary to improve Romania's financial situation by balancing the budget, reducing the current account deficit, and maintaining the upward trend of economic development.

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