External debt management in Romania

Dumitriu, Ramona and Stefanescu, Razvan

University "Dunarea de Jos" Galati, ROMANIA, University "Dunarea de Jos" Galati, ROMANIA

24 September 2013

External Debt Management in Romania

Dumitriu Ramona, Stefanescu Razvan,

University “Dunarea de Jos” Galati, ROMANIA

Abstract: This paper approaches the evolution of Romania’s foreign debt in three periods of time: during Nicolae Ceausescu regime, in the transition period and the one which followed the adhesion to European Union. For all three periods the external debt management had to deal with different circumstances: the sharp increase of real interest rates from the 1980s, the lack of credibility on international financial markets from the 1990s or the recent global crisis. We conclude that political regime, the efficiency of the allocation of the borrowed funds or the international context played major roles in the external debt management.

Keywords: External Debt, Crisis, External Deficits.

JEL Classification Codes: F34, G01, H63

Introduction

During the last decades, several financial crises provoked or, at least, aggravated by the unsustainable public debts stressed the necessity of an efficient management of the governmental borrowing. In this period of time significant changes of the global financial system led to different approaches of the debt management. The international debt crisis from the 1980s had dramatic consequences on the development and macroeconomic stability of several less industrialized countries. In the next years, other debt crises affected not only the borrowing states but also the lending institutions. The recent European sovereign debt crisis revealed the weakness of management of the governmental borrowing for some developed countries.

For many developing countries, the management of the governmental borrowing is oriented mainly to deal with the external debt. As Chenery and Strout

(1966) pointed out, these countries had to use foreign funds to manage two gaps: the first is between savings and investment, while the second is between export and import. Eichengreen and Hausmann (1999) revealed that, very often, the developing countries external debt is affected by what they called the "*original sin*": the inability of these countries to borrow from abroad in their own currencies. In these circumstances, the external debt crisis is very often accompanied by a currency crisis (Krugman, 1979; Kahler, 1985; Calvo, 1988; Brooks et al., 1998; Bulow and Rogoff, 1989; Reinhart, 2002; Kaminsky et al., 2003; Eichengreen et al., 2003).

The main role of the external debt management is the efficient administration of the borrowed foreign resources. That function implies activities such as the foreign debt monitoring, the projections of debt service payments in relationship with the macroeconomic performances or the negotiations with creditors etc. (Krugman, 1985; Kalderen, 1992; Klein, 1994; Bangura et al., 2000).

In this paper we approach the Romanian experience in managing the external debt. During the international debt crisis from the 1980s Romania, which in this period of time was led by Nicolae Ceausescu, was the single country that managed to pay back all its external debt. After the regime of Nicolae Ceausescu had fallen, in December 1989, Romania passed into a transition periods which was, in its first years, characterized by a dramatic decline of the economy and by substantial deficits of the current account. In the first years of this period of time, some political considerations and delaying the structural reforms hampered Romanian authorities' efforts to borrow from abroad. The end of the transition and the adhesion to the European Union brought the Romanian economy to other stage of development, with other circumstances of debt management.

Romanian external debt management during Ceausescu regime

In 1965 Nicolae Ceausescu succeeded Gheorghe Gheorghiu - Dej as the leader of the Romanian Communist Party. In the next years he eliminated, step by step, his main rivals. At the beginning of the 1970s he gained absolute power. He continued the politics inaugurated by Gheorghiu - Dej of dissidence within the soviet block. In 1968 Ceausescu consolidated his image of opponent to the Soviet Union hegemony by refusing to join the Warsaw Pact armies in their invasion in

Czechoslovakia. This position was rewarded by the United States and other Western countries with commercial and financial advantages. In the 1970s, Romania was the single member of Warsaw Pact country which was admitted to join the International Monetary Fund (IMF) and the World Bank.

At the beginning of the 1970s, Ceausescu started to use foreign resources to finance his ambitious plans of rapid industrialization. As a result, the external debt rose from about 30 millions USD in 1972 to more than 10 billions USD in 1981 (Figure 1).

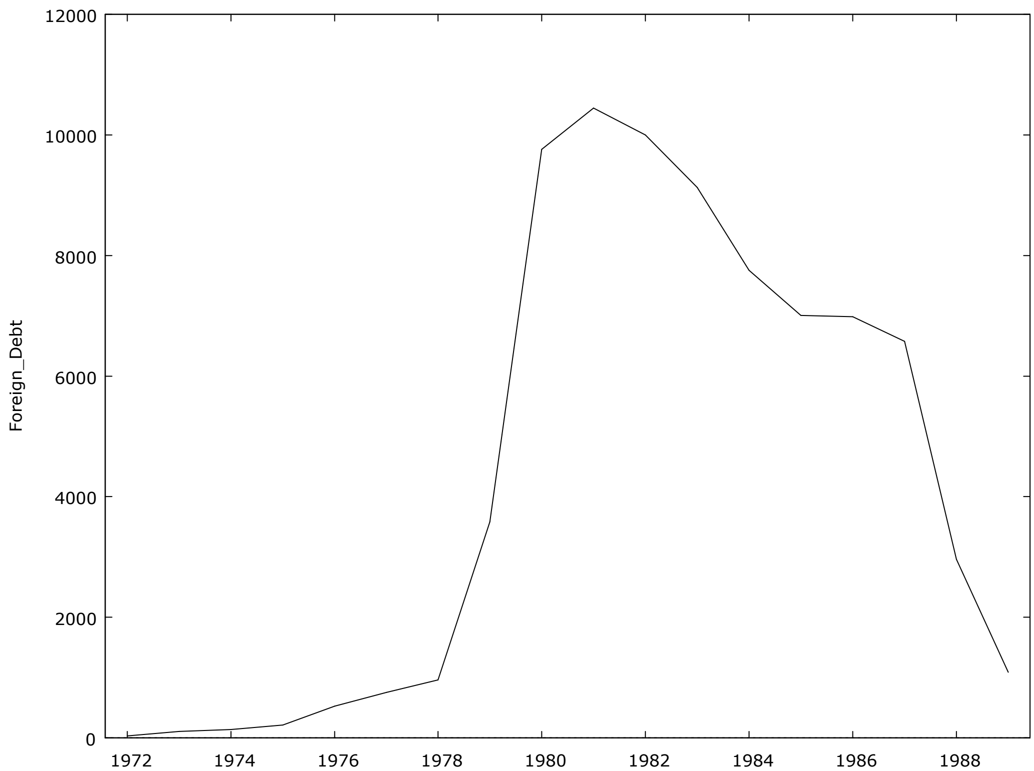

Figure 1 - Foreign debt evolution from 1972 to 1989 (millions USD)

Source: National Institute of Statistics of Romania

In fact, during the 1970s many developing countries accumulated high foreign debt which proved to be unsustainable in relation to their macroeconomic performances. Several circumstances were responsible for this evolution. In this period of time the commercial banks which benefited by substantial influxes of OPEC petrodollars increased their loans to developing countries (Stallings, 1987; Reinhart, 2010). Unrealistic and too optimistic projection over the macroeconomics performances of the developing countries justified excessive borrowing to these countries (Obstfeld, 1996; Senhadji, 1997; Bangura et al., 2000; Reinhart and Rogoff, 2011). The sharp increase of the prices for some important raw materials including oil and food grain forced many less developing countries to ask for more foreign credits.

In 1979, faced with a growing inflation provoked by the second oil price shock, the Federal Reserve of United States applied a tight monetary policy which led, in the next years, to a sharp increase of the world real interest rates. In this context, for many developing countries which had borrowed with floating interest rates, the debt services raised to unsustainable levels. In this acute stage of debt crisis the United States and some major financial international institutions, such as the International Monetary Fund and the World Bank proposed solutions which combined debt restructuring and some painful measures meant to improve the macroeconomic efficiency of the debtor countries.

In 1981, when the external debt reached a peak of 10.4 billions dollars, Romania was unable to repay its short-term debts. The Romanian leaders opened negotiations with IMF about rescheduling the external debt. However, considering the solutions proposed by IMF as limiting his control over the national economy, Nicolae Ceausescu finally rejected them. He implemented, instead, drastic measures to increase exports and to reduce imports:

- a more pragmatic approach (the efficiency consideration prevailed over the ideological ones) to the management of the national economy;

- the increasing role of the Romanian secret service (*Securitate*) on the management of the foreign trade transactions (many import and export operations were performed by firms owned by *Securitate*);

- restrictions on the import of technologies and even on some consume goods;

– the exports of consumption goods despite the needs of population.

These measures led to current account surpluses, but they had dramatic effects on Romanian people living standard. The black market flourished and the Ceausescu regime became very unpopular. In these circumstances, Nicolae Ceausescu was forced to grant more power to *Securitate* which on he relied not only to supervise the foreign trade transactions but also on its repressive capacity (Teodorescu, 1992; Pelin, 1997; Troncotă, 2003; Oprea, 2008; Betea, 2011). The impact of the austerity measures on the population living standard it is very difficult to quantify since the official statistics hid it. On the other hand, the population learned to find on the black market the goods that were missing on the official market.

Meanwhile, the international debt crisis was deepening. In August 1982 it was announced that Mexico could not honor anymore its external debt services. After that, the commercial banks became reticent to lend low income countries. In the next years, many other developing countries were unable to repay their foreign debt. In most of them the IMF plans to solve the debt problems failed because the austerity measures proved to be unbearable. Anyway, since 1983, the world real interest rates decrease reduced the external debt services (Gutowski et al., 1986; Kapstein, 1994; Easterly, 1989; Cole, and Kehoe, 1998; Detragiache, 1996; Chamon, 2004; Frank and Goyal, 2007).

At the end of 1980s, as the economic reforms promoted by Mikhail Gorbachev in the Soviet Union gained sympathy in Western countries, Romania's dissident position wasn't appreciated anymore. Western countries imposed economic sanctions for the human right violations. Nicolae Ceausescu criticized Gorbachev reforms, arguing that Romanian debt accumulation from the 1970s was caused by the exaggerated autonomy granted to the enterprises in these years. As the economic and political problems aggravated, it seemed that some entities from Securitate conspired to overthrow Ceausescu regime (Oprea, 2008; Cartianu, 2011).

Finally, Romania's foreign debt was integrally paid back in the summer of 1989. However, Nicolae Ceausescu didn't relax the austerity measures. According to some of his former collaborators, he intended to use the surpluses of the foreign trade in creating a financial institution for developing countries (Cartianu, 2011). Anyway, in December 1989 Ceausescu regime fell.

External debt management during the transition period

At the beginning of 1990s the effects of international debt crisis were much less visible than in 1980s. The assets associated to external debt were used as instrument of payments on the privatization processes from developing countries. In this period of time many developing countries started to borrow by issuing bonds on the international financial markets. The debtors credibility played a major role on such operations. Some financial crisis, in which the foreign debt was an important dimension, occurred: Mexico in 1994, South-East Asia in 1997, Russia in 1998, Argentine in 1999 etc.

In this period of time, the transition difficulties provoked a sharp decline in the Romanian economy. The exports dropped while the imports grew. The external deficits needed to be financed by foreign credits. However, the new authorities that gained the power in December 1989 were perceived by the Western governments as not very committed to democratic and economic reforms. As a result, between 1990 and 1996 for Romania it was very difficult to obtain external loans, so the foreign debt didn't experience a sharp rising, as it happened with other Eastern countries. During this period of time, Romanian authorities weren't able to borrow by issuing bonds on the international financial markets.

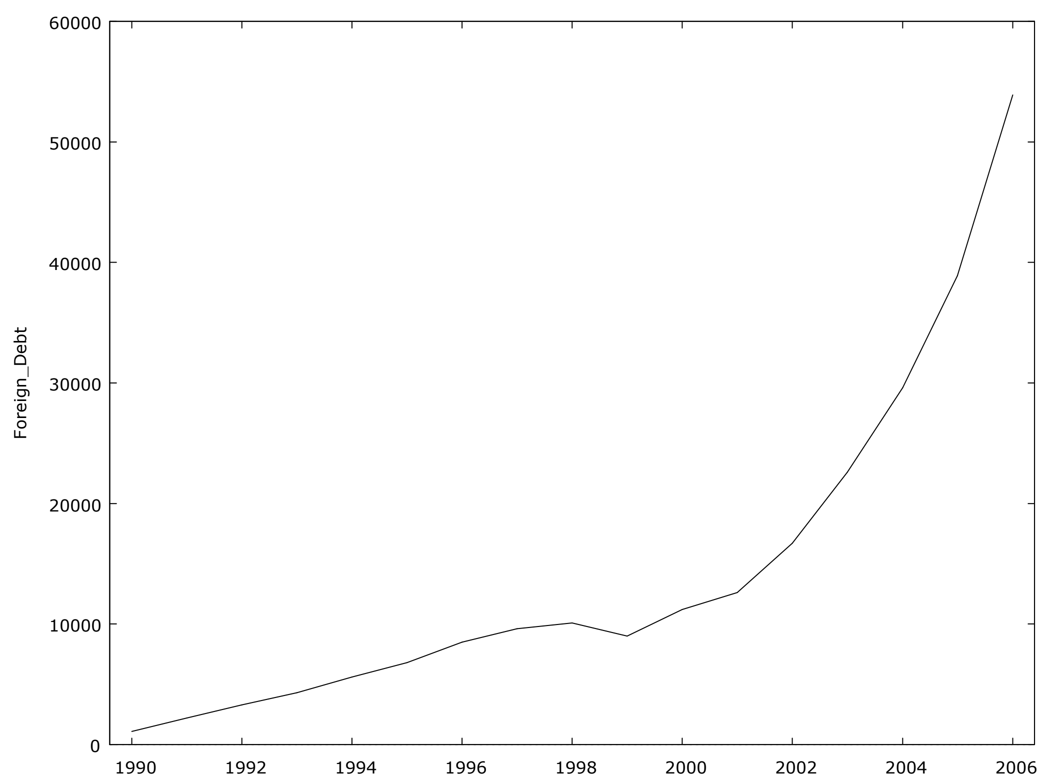

Figure 2 - Foreign debt evolution from 1990 to 2006 (millions USD)

Source: National Bank of Romania

In 1997, after the general elections, the Government was formed by a coalition of political parties which proclaimed their commitment to radical reforms. Anyway, some delays in the reforms and errors in the macroeconomic policies hampered the authorities' efforts to obtain substantial external credits (Figure 1). During the 1990s, the national currency devaluated substantially as the lack of foreign credits forced Romanian Governments to finance its deficits by monetary expansions (Table 1).

Table 1 - Indicators of Romania's macroeconomic stability between 1990 and 1999

Year	Exports [mil. USD]	Imports [mil. USD]	Inflation rate [%]	Exchange rate [ROL / USD]	Real GDP growth [%]
1990	5 775.4	9 202.5	5.1	22.43	-5.6
1991	4265.7	5 372.0	170.2	76.39	-12.9
1992	4363.4	5784.1	210.4	307.95	-8.8
1993	4892.2	6020.1	256.1	760.05	1.5
1994	6151.3	6562.4	136.7	1655.09	3.9
1995	7910.0	9487.0	32.3	2033.26	7.1
1996	8084.5	10555.0	38.8	3082.60	3.9
1997	8431.1	10411.4	154.8	7167.94	-6.1
1998	8302.0	10926.6	59.1	8875.55	-4.8
1999	8502.8	9595.1	45.8	15332.93	-1.2

Source: National Bank of Romania

From 2000 to 2006, the benefits of reforms became visible and the main difficulties of transition were surpassed and the real GDP passed from negative to positive rates (Table 2). Romania still experienced significant current account deficits, but this time it was able to obtain substantial foreign credits. As a result, the foreign debt sharply increased, while the inflation rate decreased step by step (Figure 2). The substantial inflows of foreign investment and remittances of Romanian workers from foreign countries caused the national currency to pass from devaluation from 2000 to 2004 to revaluation from 2005 to 2006 (Table 2).

Table 2 - Indicators of Romania's macroeconomic stability between 2000 and 2006

Year	Exports [mil. EUR]	Imports [mil. EUR]	Inflation rate [%]	Exchange rate [RON / EUR]	Real GDP growth [%]
2000	11273	13140	45.7	1.9956	2.9
2001	12722	16045	34.5	2.6027	5.7
2002	14675	17427	22.5	3.1255	5.1
2003	15614	19569	15.3	3.7556	5.2
2004	18935	24258	10.18	4.0532	8.5
2005	22255	30061	9.00	3.6234	4.2
2006	25850	37609	6.56	3.5245	7.9

Source: National Bank of Romania

External debt management after Romania's adhesion to the European Union

Romania's adhesion, in January 2007, to the European Union stimulated both exports and imports. From 2007 to 2008, the imports grew faster than the exports, so the deficits of the current account increased. This time, for Romania it was easier to borrow from abroad since the adhesion increased its credibility on the international financial markets. In these circumstances, the external debt continued to rise. The real GDP increased with significant rates, but it was a growth based on borrowing.

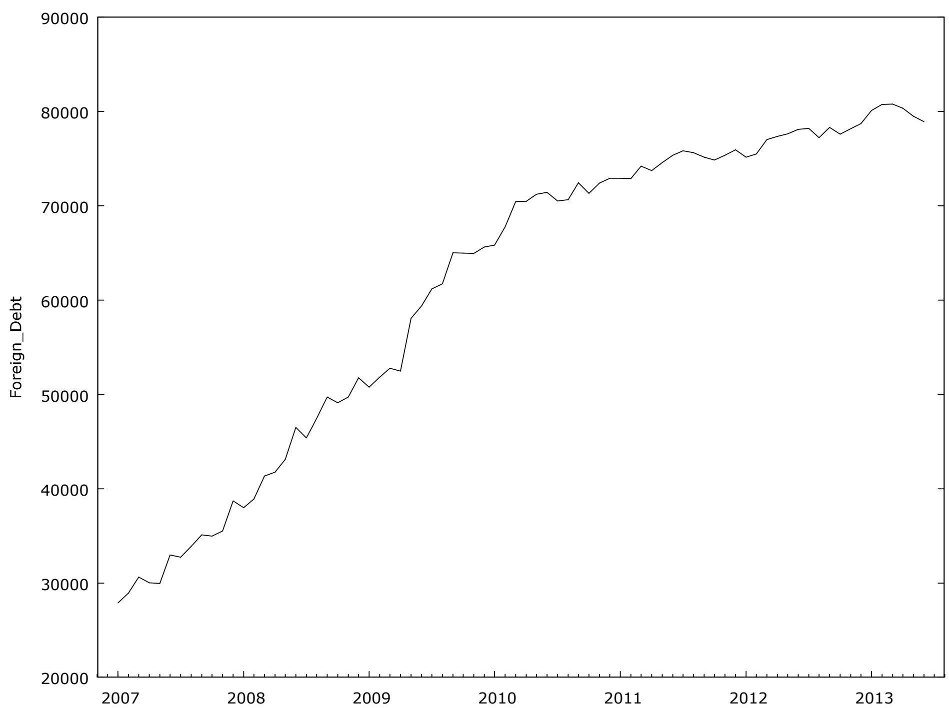

Figure 2 - Foreign debt evolution from January 2007 to June 2013

millions euro)

Source: National Bank of Romania

Since the end of 2008 Romania has been affected by the global crisis. The national currency suffered a substantial depreciation and the GDP decreased, in real terms, during 2009 and 2010 (Table 3). During the global crisis the deficit of the current account was reduced not only because the decline of consumption, but also because the exports of some cheap Romanian products were preferred in the recession context. Although the current account deficits were reduced, Romania was forced, in 2009, to demand credits from international financial institutions to fill the public deficits. As a result, the foreign debt raised sharply (Figure 2).

During the global crisis several countries, including industrialized countries, experienced difficulties in paying back their debts. This situation led to new approaches of public debts, including foreign debts (Arghyrou and Tsoukalas, 2010; Checherita and Rother, 2010; Santis, 2012).

Table 3 - Indicators of Romania's macroeconomic stability

between 2007 and 2012

Year	Exports [mil. EUR]	Imports [mil. EUR]	Inflation rate [%]	Exchange rate [RON / EUR]	Real GDP growth [%]
2007	29549	47371	4.84	3.3373	6.2
2008	33725	52834	7.85	3.6827	7.3
2009	29084	35955	5.59	4.2373	-6.6
2010	37360	44937	6.09	4.2099	-1.1
2011	45274	52683	5.79	4.2379	2.2
2012	45056	52430	3.33	4.4560	0.7

Source: National Bank of Romania

Conclusions

In this paper we approached the Romanian foreign debt management during three periods with different circumstances. Some factors such as the political regime, the borrowed funds allocation efficiency or the international context influenced significantly the foreign debt evolution.

The analysis of the making and paying back of the external debt during the 1970s and 1980s has to take into consideration some characteristics of the political regime. A brilliant foreign policy allowed Romania to obtain substantial credits. However, the inefficient allocation of these financial resources made the country vulnerable to the 1980s international debt crisis. The decision to pay back all the foreign debt was substantially influenced by Nicolae Ceausescu's personality and by his fear that applying the international financial institutions plans to solve the debt problem could undermine his control over the country. The significant involvement of the Romanian secret service in the efforts to pay back the foreign debt had a major impact over decades. In the years that followed the fall of the communist regime, many former officers of *Securitate* exploited their experience in foreign trade becoming successful businessmen.

During the first years of the transition period, the lack of credibility didn't allow Romanian authorities to obtain significant credits. Although this situation led to substantial inflation and to a high devaluation of the national currency, it kept the foreign debt to a relative low level.

In the context of the global crisis, Romania had to borrow substantially from international financial institutions. Although, in comparison with other European countries, the foreign debt is still relatively low, its sharp growth for the last years should worry the Romanian authorities.

The recent debt crisis reignited the debate over financing the public deficits. The effects of borrowing with high interest rates could be almost bad as printing money.

References

Arghyrou Michael G. and Tsoukalas John D. (2010), *The Greek Debt Crisis: Likely Causes, Mechanics and Outcomes*, CESifo Working Paper No. 3266

Bangura Sheku, Damoni Kitabire, Powell Robert (2000), *External Debt Management in Low-Income Countries*, IMF Working Paper 00/196

Betea Lavinia (2011), *I se spunea Machiavelli*, Editura Adevărul Holding, Bucureşti

Brooks, Ray and Cortes, Mariano and Fornasari, Francesca and Ketchekmen, Benoit and Metzgen, Ydahlia (1998), *External Debt Histories of Ten Low-Income Developing Countries: Lessons from Their Experience*, IMF Working Paper, Vol. , pp. 1-141, 1998. Available at SSRN: http://ssrn.com/abstract=882352

Bulow, Jeremy and Rogoff, Kenneth (1989), *Constant Recontracting Model of Sovereign Debt*, Journal of Political Economy, Vol. 97, pp. 155–178.

Calvo, Guillermo (1988), *Servicing the Public Debt: The Role of Expectations*, American Economic Review, Vol. 78, pp. 647–661.

Cartianu Grigore (2011), *Cartea revolutiei*, Editura Adevărul Holding, Bucureşti

Chamon, Marcos (2004), *Can Debt Crises Be Self-Fulfilling?*, IMF Working Paper, WP/04/99

Checherita, Christina and Rother, Philipp (2010), *The Impact of High and Growing Debt on Economic Growth and Empirical Investigation for the Euro Area*, European Central Bank Working Paper Series No. 1237

Chenery, H.B. and Strout, A.M. (1966), *Foreign Assistance and Economic Development*, American Economic Review No. 56 (September), pp. 680-690.

Cole, Harold and Kehoe Patrick (1998), *Models of Sovereign Debt: Practical vs. General Reputations*, International Economic Review, Vol. 39, pp. 55–70.

Detragiache, Enrica (1996), *Rational Liquidity Crises in the Sovereign Debt Market: In Search of a Theory*, Staff Papers, International Monetary Fund, Vol. 43, pp. 545–570.

Easterly, William R. (1989), *Fiscal Adjustment and Deficit Financing During the Debt Crisis*, In I. Husain and I. Diwan, eds., Dealing with the Debt Crisis, Washington DC: The World Bank: 91–113.

Eichengreen, Barry and Hausmann Ricardo (1999), Exchange Rates and Financial Fragility, in New Challenges for Monetary Policy, Kansas City, Missouri: Federal Reserve Bank of Kansas City, pp. 329 - 368.

Eichengreen B. and Hausmann R. and Panizza U. (2003), *Currency mismatches, debt intolerance and Original Sin: Why they are not the same and why it matters*, NBER Working Paper No. 10036

Frank, Murray Z. and Goyal, Vidhan K. (December 8, 2007), *Trade-Off and Pecking Order Theories of Debt*, Available at SSRN: *http://ssrn.com/abstract=670543*

Gutowski, A. and Holthus, M. and Kebschull, D. (1986), *Indebtedness and Economic Growth in Developing Countries* (Hamburg: HWWA).

Kahler, M. (1985), *Politics and international debt: Explaining the crisis*, International Organization, 39(3), pp. 357-382.

Kalderen, Lars (1992), *Institutional aspects of external debt management*, in Managing External Debt in developing Countries: Proceedings of a Joint Seminar, Jeddah, ed. by Thomas M. Klein, pp. 87-97.

Kaminsky, Graciela L. and Reinhart Carmen M. and Carlos Vegh (Fall 2003), *The Unholy Trinity of Financial Contagion*, Journal of Economic Perspectives, Vol. 17 No. 4, pp. 51-74.

Kapstein, Ethan B. (1994), *Governing the Global Economy: International Finance and the State* (Cambridge, MA: Harvard University Press

Klein, Thomas M. (1994), *External Debt Management: An Introduction*, World Bank Technical Paper No. 245 (Washington: World Bank).

Krugman, Paul (1985), *International Debt Strategies in an Uncertain World*, in International Debt and the Developing Countries, Gordon W. Smith and John T. Cuddington eds., pp. 79–100 (Washington: World Bank).

Krugman, Paul (1979), *A model of balance of payments crises*, Journal of Money Credit and Banking, 11: pp. 311-25.

Obstfeld, M. (1996), *Models of currency crises with self-fulfilling features*, European Economic Review 40: pp.1037-1048.

Oprea, Marius (2008), *Moştenitorii Securității*, Editura Humanitas, Bucureşti.

Pelin, Mihai (1997), *DIE 1945-1980. Din culisele spionajului românesc*, Editura Evenimentul Românesc, Bucureşti.

Reinhart, Carmen M. (2010), *This Time is Different Chartbook: Country Histories on Debt, Default, and Financial Crises*, NBER Working Paper.

Reinhart, Carmen (2002), *Default, currency crisis, and sovereign credit ratings*, NBER Working Paper Series, no. 8738.

Reinhart Carmen and Rogoff Kenneth (2011), *A Decade of Debt*, Centre for Economic Policy Research, Discussion Paper No. 8310.

Santis De Roberto A. (2012), *The Euro Area Sovereign Debt Crisis Safe Haven, Credit Rating Agencies and the Spread of the Fever from Greece, Ireland and Portugal*, European Central Bank Working Paper Series No. 1419.

Senhadji, Abdelhak (1997), *Sources of Debt Accumulation in a Small Open Economy*, IMF Working Paper 97/146 .

Stallings, Barbara (1987), *Banker to the Third World: U.S. Portfolio Investment in Latin America*, 1900-1986, University of California Press.

Teodorescu Filip (1992), *Un risc asumat*, Editura Viitorul Românesc, Bucureşti.

Troncotă Cristian (2003), *Duplicitarii. O istorie a Serviciilor de Informații și Securitate ale regimului comunist din România*, Editura Elion, București.