

PROSPECTS FOR ACHIEVING ROMANIA'S EXTERNAL EQUILIBRIUM

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Abstract

The COVID-19 pandemic, the health protection measures, and the policies meant to limit the economic effects of the disease have affected the world's economies on multiple levels, the international trade being one of the most seriously influenced domains. The paper¹ aims to highlight the effects of the pandemic on Romania's current account, as well as some directions of action aimed at improving the external deficit of our country. The methodology used in the article joins the empirical analysis of statistical data and their interpretation, with the identification of causalities. The analysis shows that the uncertainty regarding the evolution of COVID-19 and the measures adopted by the authorities to stop the spread of the coronavirus affected negatively, especially in 2020, the current account, and its way of financing. The paper highlights some elements that can hamper the decrease of the external deficit in the future (the large needs of external financing in the coming years, the dependence of the economy on imports, the unfavourable structure of Romanian exports and imports), as well as some directions of action intended to support the improvement of the external deficit of our country, including supporting the recovery of the economy, reducing the budget deficit, improving the domestic offer, and the research and innovation activity, etc.

Keywords: external deficit, foreign relations, external financing, vulnerabilities, COVID-19 crisis

JEL Classification: F32; F34; H63

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1. Introduction

The world economy and trade have a strong impact on the states of the world, the participation of the countries to international economic and financial exchanges being a condition and an important source for achieving sustainable economic growth. The economic exchanges, regardless of the methods of accomplishment, are essential both for domestic balance and economic growth, as well as for economic development at regional or at the company level.

The equilibrium is an aspirational goal, being more a theoretical concept that may never occur in an economy because the conditions underlying supply and demand are often dynamic and uncertain. The situation of all economic variables is constantly changing. Thus, the economy pursues equilibrium without actually achieving it.

The COVID-19 pandemic, which has outburst in 2020, has been a major shock for the economies, and it has caused a sudden and deep recession both at the level of the European Union and at the world level, testing the health and social protection systems, the companies and the economies. The consequences drawn by the evolution of the pandemic, by the health protection measures and by the policies meant to limit the economic effects of the disease have negatively affected industrial production, services, consumer spending, trade, supply chains, investments and capital flows.

These developments exhibited at the domestic and international level support the topicality of the subject discussed, on the background of the displayed effects of the measures adopted to prevent the spread of COVID-19, but also of the challenges that our country must face in the perspective of joining the euro area.

In the article, the author aims to highlight the effects of the pandemic on Romania's current account, as well as some directions of action aimed at the improvement of the external deficit of our country. For this purpose, the paper is structured in three parts. In the first part, the evolution, characteristics, and way of financing of Romania's current account deficit are analysed, with an emphasis on the years 2020-2021. In the second part, the prospects, and obstacles in the way of achieving the external balance of our country are shown. The paper ends with conclusions where the most important results of the research are presented.

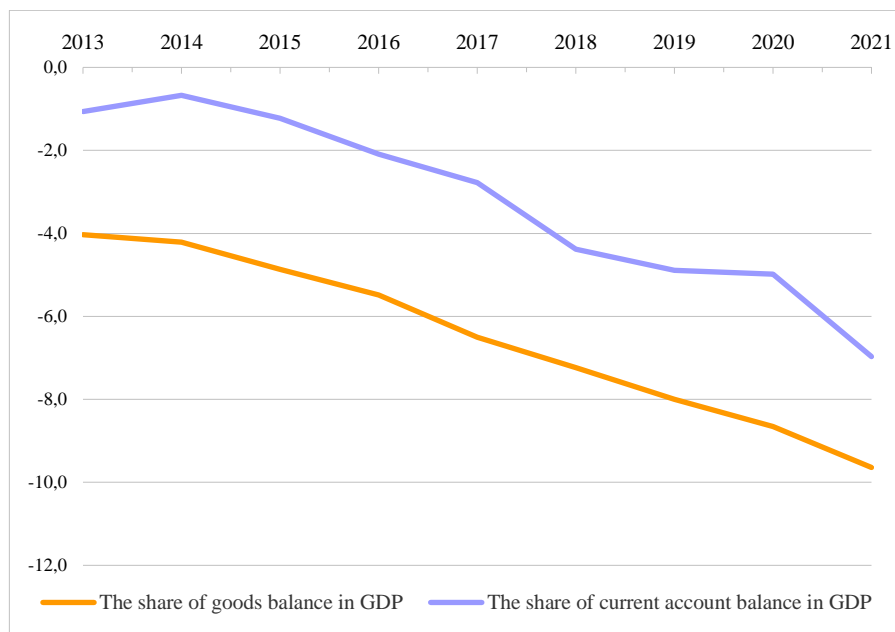
2. Romania's external account: trend, characteristics, financing

The uncertainty caused by the evolution of COVID-19, as well as by the measures adopted by the authorities at national and international level in order to prevent the spread of the coronavirus, has caused the temporary failure of production and of global supply chains; also, the decrease of domestic production and external demand, negatively affecting Romania's external balance, influencing exports to diminish (more than imports), the current account deficit to increase, as well as its financing in terms of sources and costs (by reducing foreign direct investment inflows and increasing costs), as a result of the risk aversion of investors.

Thus, Romania's current account deficit was large and slackened in 2020 and increased significantly in 2021 (by 53.5%) (continuing the upward trend started since 2004 - steep declines occurring only in 2009, 2013 and 2014). As a share of GDP, the current account deficit has reached 7% in 2021, from 1.2% in 2015 (4.9% in 2019) (see Figure 1). In the years before COVID-19, the current account balance has deteriorated due the increase in domestic demand, boosted by fiscal measures, with effects in a sharp increase in imports of consumer goods.

The trend of the current account balance in our country has been mainly due to the trend of the goods balance (increase from -4% in 2013 to -9.6% in GDP in 2021) (see figure no.1), supported by the high consumption demand from the period of significant GDP growth (2013-2019) (NBR, 2016-2021) (taking into account the fact that part of the demand surplus has been satisfied from imports, leading to their increase); and by the contraction of the global economy in 2020 and 2021 (which has caused the decrease of Romania's external demand).

Figure 1
The evolution of the share in GDP of the goods balance and the current account balance in Romania during the period 2013-2021 (%)



Source NBR data, author's calculation

The sharper drop in exports compared to imports in 2020, the first year of the pandemic, has led to the increase in the negative balance of the goods and current account.

The evolution of the exports structure in 2019 and 2020 (the increase in the share of exports of capital and consumer goods, and the decrease in the share of exports of intermediate goods) is positive for the current account balance, but it is necessary to continue this trend.

In contrast, *the structure of imports and its evolution are of concern*, given that from 2016 till present, imports of consumer goods have generally grown faster than imports of other goods. In 2020, imports of capital goods have also increased.

Romania's current account deficit has been financed after 1990 mainly through foreign direct investments, with a decreasing share

between 2015 and 2020, against the background of the sharp increase in the negative balance of the current account. The way of financing the external deficit has suffered a breaking point in 2020, namely foreign direct investment inflows have decreased, due to the risk aversion of investors amid the uncertainty generated by the effects of the measures adopted to stop the spread of the coronavirus and the uncertainty regarding the evolution of the disease. As a result, Romania had to resort to external loans and portfolio investments, with effects of increasing costs and the total external debt, and implicitly the risks related to the repayment and sustainability of the external debt.

Thus, in 2020, portfolio investments have been the main source of financing the current account deficit (with a significant annual increase (468%), representing the highest value of this indicator since 1990), in the structure being mostly long-term debt instruments.

In 2021 the situation has improved. Thus, the coverage of Romania's current account deficit through foreign direct investment inflows has increased compared to the previous year, almost reaching the value before the COVID-19 crisis (of 2019), which shows the decrease in investors' risk aversion and the improvement in foreigners' perception of our country.

Our country's current account deficit is largely brought about by the high budget deficit. The financing of the budget deficit generates public, internal and external debt. In both 2020 and 2021, the government managed to meet its external financing needs (aimed mainly to mitigate the impact of the COVID-19 shock and to facilitate the recovery), despite the increased uncertainty due to the effects of COVID-19 and of the measures adopted to end this disease, and to temporary tensions in financial markets amid greater risk aversion in global financial markets and capital flight. This has increased Romania's public indebtedness, but it should support medium-term adjustment.

Thus, the annual increase in medium and long-term external public debt from 2020 (46%) has been the most important since 1990, (exceeding the jump in medium and long-term public debt due to the economic-financial crisis of 2008, felt in Romania in 2009, 2010). More than a third of the debt obtained in 2020 has been used to refinance maturing external public debt.

Also, in 2020, against the background of the expenses entailed by the COVID-19 pandemic, the largest increase in the total external debt from 2009 til present is recorded (as an annual rate, 15.5%). In

2020, the share of total external debt in GDP has increased from 49% in 2019 to 58%, the fastest increase recorded in the analyzed time frame, after that of 2009, when it increased from 52% of GDP in 2008 to 69%.

In 2021, the increase in total external debt and external public debt has been lower compared to the previous year, of 6.2% and 1.4%, respectively. Direct external public debt reaching EUR 58 billion in December 2021. Among the components of long-term external debt, direct public debt has had the majority share since 2017, in 2021 representing 60%.

The increase in the costs of direct public external debt is also due to the replacement of the creditors' types - from multilateral institutions (60% in 2006), and government securities (35% of the amounts attracted), mainly to bonds (80.7% in 2021).

3. Prospects and impediments in achieving Romania's external equilibrium

After the decrease from 2020, in Romania, in 2021, the economic activity has had a recovery beyond expectations, which has also involved a slight upward correction of the cyclical component (GDP gap), and the investment process has been dynamic.

Maintaining the positive trend of economic growth in our country depends on the actual measures to support the economy, on the fructification of the increased budget of the European Union in the coming years, on the recovery of production and distribution chains in Europe and on the economic evolution of the European countries, our main trade partners.

Romania must calibrate its appropriate mix of macroeconomic policies, taking into account the vulnerabilities of the economy, including: large budget and current account deficits, significant degree of Euroization, high inflation. Economic policy measures should also focus on mitigating the impact of COVID-19 shocks and on facilitating the recovery of the economy. This involves adjusting the economy in the medium term through stronger economic fundamentals, but it generates the increase of the debt.

The measures for the economic rebound should rely on the mobilization of the funds necessary for the recovery of the economy. Investments are the engine of economic growth and job creation, with a multiplier effect and direct contribution to fix capital gross formation.

In situations of economic stagnation or crisis, the economic literature recommends large investment expenditures of the public sector. In addition, from 2021, Romania can take advantage of the availability of a large volume of European funds for economic recovery.

Thus, in the period 2021-2027, within the Cohesion policy for 2021-2027, Romania has been allocated European funds of 31.35 billion euros, and through the "Recovery and Resilience Mechanism" facility, it has an allocated budget of 30.4 billion Euros, funds that can be used in key areas, such as: infrastructure, education, health, agriculture, environment, or energy, as well as for the modernization of large public systems. Making investments in strategic areas leads to the modernization of these sectors with effects of improving the internal supply (namely increasing exports and decreasing imports), and therefore the external balance.

On the other hand, it must be taken into account that the prospects of the economic evolution and of the improvement of Romania's external balance are marked by uncertainties and risks, essentially generated by:

- the pursuit of the pandemic, situation that has a more significant and lasting impact on the economy (and which requires the health authorities to provide suitable treatments based on the experience from the last almost 3 years), then by
- the risk that the negative effects caused by the pandemic in the economy (such as bankruptcies, long-term unemployment and disruptions in supply) should be deeper and broader,
- the risk that the world economy and trade will not improve or that trade tensions will increase,
- the occurrence of pressures on financial markets, with negative effects on borrowing costs, in the context of investors' risk aversion and reduced liquidity.

Forecasts of large fiscal deficits in the next years (around 7.1% of GDP in 2022 according to the European Commission's spring (2021) forecast) imply high external financing needs in the coming years as well. Under these conditions, there will continue to be pressures both on the current account (to record a large deficit), as well as for having a high and even higher level of the external debt, which stood at 136.6 billion euros at the end of 2021. The elevated costs of the credits granted to our country on the international markets compared to those of the other countries in the European Union, in the context of the

assessment of Romania's sovereign debt in 2019-2020 at the lowest investment grade by the main rating agencies, causes concerns about the financing of a rising debt stock. Thus, financing external borrowing needs could become more uncertain and more costly.

The prospects of the public debt growth, and of financing a significant share of the debt further from abroad, in foreign currency, will contribute to the worsening of the external position of our country.

Under these conditions, we believe that measures should be adopted in order to reduce the budget deficit, and for fiscal consolidation. It is also necessary to set the priorities, to have prudence and moderation in making the budgetary fiscal policies for the build-up of fiscal space, which should be directed towards the financing of policies and expenditures with an impact on sustainable economic growth.

Romania has an economy dependent on imports. If private consumption recovers, imports will resume their upward trend (higher than that of exports) with effects in the direction of maintaining the current account deficit at a high level.

Thus, as a result of the sharp increase in the trade deficit in the first 8 months of 2022 (by 47% compared to the same period in 2021), the current account deficit has also increased (by 59%) (NBR, 2022).

In addition, the structure of imports and exports influences negatively the evolution of the external equilibrium in our country. Thus, exports consist mainly of intermediate goods, although in recent years the share of exports of capital and consumer goods has increased. Improving the structure of goods exports depends on supporting efficient activities, by attracting investments in sectors with high added value, respectively by increasing the ability of Romanian companies to adapt to the standards of foreign markets and to face possible unfavourable developments.

The evolution of the structure of imports is worrying, given that since 2016, imports of consumer goods have generally grown faster than imports of other goods.

Unlike many other member states of the European Union, in Romania, sectors less exposed to foreign competition (both in terms of exports and the penetration of imports) have grown more than tradable sectors in recent years, which can represent an impediment in the path of the development of some fields producing export goods.

As a result, in order to diminish the current account deficit, we consider it necessary to stimulate the improvement of the domestic

offer both quantitatively and qualitatively, offering quality products with a high degree of processing, which satisfy the needs of Romanian and foreign consumers.

To this end, we consider it useful to improve the research and innovation capacity of the economy, including by increasing the expenditures allocated to research-development-innovation, in order to support the growth of the production of high added value goods, which should incorporate high technology. This should favour the production of Romanian goods meant to meet both internal and external demand, as well as the improvement of the exports structure and of the trade balance of high-tech products.

Likewise, the correlation of the current account deficit with its sources of financing should be pursued, in order to stabilize and even increase the sources of financing not bearing interest (foreign direct investments and capital transfers).

The trend in recent years of covering the external deficit through portfolio investments concurs to the accrual of external debt, especially of public debt, as well as to the expansion of the current account deficit in the medium and long term due to increasing capital outflows through the account of Income from portfolio investments.

In addition, in order to support the improvement of our country's current account, we consider it necessary to reduce the dependence of the Romanian economy on energy imports, and to use the national energy resources, in order to diminish the deficit of the energy trade balance.

A possible degradation of external conditions, against the background of increased trade tensions, of an exacerbated risk aversion or of the slowdown in economic growth of Romania's main trading partners, could lead to further deterioration of the current account.

The adoption of the single currency may raise problems for our country's external equilibrium. The loss of the "exchange rate" tool and its lack of support to the competitiveness of Romanian goods may negatively affect Romania's exports, differentiated, however, for the trade with the countries within the European monetary area, for trade with member countries of the European Union (outside the euro zone) and, for the trade relations with countries outside the European Union. The intensity of the effects depends on the improvement in the exports structure in the sense of the increase of goods with a high degree of processing and high added value.

The prospects of lower wage growth will reduce the pressure on cost competitiveness, with effects in improving labour productivity and reducing the external imbalance, evolution also supported by the freezing of wages in the public sector and by a very limited increase in the minimum wage in 2021. However, non-cost factors (such as scarce infrastructure, especially in poorer regions; the difficult business environment favoured by political and legislative unpredictability; skills shortages and the high share of the low skilled workforce, in the context of the fast demographic decline, combined with deficiencies in the education and vocational training sector; the low capacity for innovation), allow only limited possibility of manoeuvre to counteract the evolution of cost competitiveness, continuing to represent a brake to the improvement of export competitiveness, and implicitly of the external disequilibrium.

Both in order to stimulate investments and competitiveness, measures should be taken to improve the infrastructure both qualitatively and quantitatively.

Also, the ongoing exhibition of legislative unpredictability represents threats to financial stability and to the inveigling of foreign investments; it affects the business environment, and it may influence negatively the confidence and the risk premium required by creditors and international investors with a negative impact on the external balance, in terms of the costs and instruments financing the external imbalance. Therefore, we believe that measures are needed to mitigate threats to financial stability and investments, as well as general legislative unpredictability, by implementing appropriate laws that are well-drafted and verified before they are adopted, so that there is no need for subsequent corrections, and which should support the sustainable development of the economy. We consider it useful to advise with the relevant stakeholders in policy making and the ex-ante impact assessment.

4. Conclusions

The uncertainty caused by the evolution of COVID-19, as well as by the measures adopted by the national authorities and commercial partners in order to stop the spread of the coronavirus, have caused a decrease in external demand, affecting negatively Romania's external balance, the decrease of exports (more than imports), the growth of the current account deficit, as well as its

financing from the point of view of sources and costs (by reducing foreign direct investment inflows), as a result of the risk aversion of investors against the background of the uncertainty generated by the effects of these measures, and the increase in the share of debt-generating financing sources (foreign loans and portfolio investments). These developments represent a source of vulnerabilities and risks for Romania's external equilibrium, in terms of the repayment effort and of the external debt sustainability.

In addition, the evolution of the COVID-19 pandemic, the ability to recover and the possible structural implications of the crisis are still uncertain, which implies caution in forecasts in general, and in terms of the possibilities of achieving the external balance of Romania, in particular. Overall, policy actions over the past year have focused on mitigating the impact of the COVID-19's shock and on facilitating the recovery. This has increased Romania's public indebtedness but should support medium-term adjustment.

The structure of imports and exports influences negatively the evolution of the external deficit in Romania, the trend of the structure of imports being worrisome, considering the fact that since 2016, imports of consumer goods have generally grown faster than imports of other goods, evolution that is not favourable to long-term economic growth.

Considering that the prognoses show further increase of the external deficit and of the public debt and the financing of a significant share of the debt from abroad, in foreign currency, leading to the worsening of the external position of our country, political actions are necessary to address the vulnerabilities from the Romanian economy (including: large current account and budget deficits, fragile public budget, with low own revenues, high degree of Euroization of the economy). In particular, measures are needed to improve the structure of the domestic offer both quantitatively and qualitatively, offering quality products with a high degree of processing, which should satisfy the needs of Romanian and foreign consumers.

For Romania, which is a country dependent on imports, but also concerned with development and joining the euro area, achieving the external equilibrium as a medium and long-term trend is imperative in order to avoid the enhancement of internal imbalances when performing in the single currency area, alongside more developed countries and/or with smaller external deficits.

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