

TREND AND CHARACTERISTICS OF THE EXTERNAL DEFICIT IN ROMANIA IN THE POST- PANDEMIC PERIOD

Camelia MILEA, PhD*

Abstract

The external disequilibrium has been a constant of the Romanian economy since 1990, and it represents one of the main vulnerabilities of the national economy. In the article¹, the author analyses the evolution of Romania's foreign deficit during the recent years, highlighting some of its characteristics. The research shows that the external deficit is generated by the negative balances of goods and of primary income, and it is partly offset by the surplus of the balances of secondary income and services. It is also shown that the structure of Romanian exports is dominated by goods with low added value and a low degree of processing, which do not help to obtain high prices in foreign markets. The economic slowdown of the European Union countries (the main trade partners of Romania) in recent years is a cause of the slower growth of Romanian exports. The methodology used joins the descriptive analysis with the empirical analysis and data interpretation, as well as the identification of correlations.

Keywords: foreign disequilibrium, structure, causes, evolution, European Union

JEL Classification: F14, F24, F32

1. Introduction

The external disequilibrium has been a characteristic of the Romanian economy since 1990 up to present, and it represents one of the main vulnerabilities of the domestic economy.

* *Scientific Researcher III, "Victor Slăvescu" Centre for Financial and Monetary Research, Romanian Academy, Bucharest.*

¹ *The article is based on "Romania's external deficit in the current domestic and international conditions", Milea C. (coord.), a research project of the "Victor Slăvescu" Centre for Financial and Monetary Research, elaborated in 2023.*

The extension of the medical crisis, the emergence of other crises (food, energy, etc.), the increase in uncertainty regarding global economic growth, and the evolution of the war between Russia and Ukraine and of the conflict in the Middle East, as well as the challenges that our country must face in the perspective of joining the euro area, represent factors of risk for the evolution of the Romanian current account balance nowadays. In addition, the level still high of the core inflation in 2023 (above that from the pre-pandemic period) had adverse implications on commodity markets and global supply chains.

The subject analysed is important as the current deficit is part of the imbalances that Romania's economy faces and is trying to mitigate in the context of joining the euro area.

The paper is structured in four parts. So, after the introduction, the data and methodology used are presented. Then, there is the section on results and discussions. In the first part of this section, the author presents the trend and the characteristics of the foreign deficit and its components in Romania in the period 2021-2023. In the second part, there is a literature review on the sustainability threshold of the current account deficit and an empirical analysis on this subject for Romania. The last section provides the conclusions of the paper.

2. Data and methodology

In the article, we compute data for some indicators after 2006, but the in-depth analysis covers the period 2021-2023 in order to capture the evolution of Romania's external sector after the COVID-19 pandemic.

The statistics have been taken mainly from the National Bank of Romania, and there are annual data.

The methodology used joins the descriptive analysis with the empirical analysis and data interpretation, and also the identification of correlations. In the empirical analysis, we use statistical indicators such as annual growth rate (to make comparisons in time of the trend of the current account deficit and its components), shares (to show the structural causes of the current account deficit and of the goods deficit, the structure of exports and imports in terms of production stages and from the point of view of customs classification, as well as the structure of imports, exports and goods balance deficit from a geographical perspective). We also compute the share of some indicators in GDP.

3. Results and discussions

3.1. Trend and characteristics of the foreign deficit in Romania

In Romania, the foreign deficit is represented by the negative balance of the current account, which is generated by the deficit of the goods balance.

In the years preceding the pandemic, the deficit in the balance of goods was deepening sharply, an evolution brought about by the faster increase in imports compared to exports in the context of a domestic demand not fully satisfied at the national level, especially for consumer goods. The increase in the deficit of the balance of goods moderates in 2020, but it resumes its high growth in 2021 and, especially, in 2022, showing the existence of structural problems in the Romanian economy that remain unsolved. In 2023, the deficit of the balance of goods decreases.

The uncertainty caused by the evolution of covid-19, as well as the measures adopted by the national authorities and by the trading partners in order to stop the spread of the coronavirus, has led, in 2020, to a decrease in external demand, as well as disruptions in production and supply chains at national and international level, affecting negatively the Romania's export offer, and implicitly the external balance. Thus, exports had a negative growth rate (higher than the decrease in imports). As a result, the deficit of the current account and of the trade balance have increased, but much less compared to the previous period. As it concerns the components of the current account, there is a slight increase in the surplus of services and the deficit of primary income, as a result of the small decrease in remittances from workers with work commitments of less than one year; the surplus of secondary income increases as a result of the decrease in the public administration deficit (more inflows of European funds come into the country than in the previous year).

The current account has begun to rise again sharply, in the first part of 2021, as before the outbreak of the pandemic, and before the 2008 crisis. At the European level, Romania had the third highest value of the current account deficit both in 2021 (after France and Greece) and in 2020. (NBR, 2022a).

The current account negative balance increased by 60% compared to the previous year, in 2021, mainly due to the growth in the deficit of the balance of goods, and in the deficit of the primary income sub-account (by 46%) (as a result to the increase in the outflow

of income from direct investments, the profit reinvested in direct investment companies in Romania), and to the decrease in the surplus of secondary income (by 45%) (generated by the rise in the deficit of secondary income of the general government in the context of the decrease in the inflow of non-refundable European funds used for current expenses - the European Social Fund, the European Fund for Agriculture and Rural Development, and the increase in the contribution to the EU budget). The balance of services had a surplus comparable to that of 2020, given that the rise in the deficit of tourism services, associated with the resumption of international travel, was offset by the increase in the surpluses of ITC services and transport services.

The deficit in the balance of goods increased by 22% compared to the previous year, against the background of equal growth rates of exports and imports, as a result of the relaunch of economic activity. Thus, the alert pace of domestic demand, in the context of the structural problems of the Romanian economy (deficiencies in the agri-food sector, the high share of energy-intensive sectors and low energy efficiency, increased dependence on import consumption) led to a significant increase in the imports of goods. There were also negative effects generated by the global synchronization of the recovery of economies (supply bottlenecks and generalized rises in raw material prices). Thus, the global semiconductor crisis caused a decrease in the development rate of the automotive industry, a sector that concurs with over 20% of Romania's exports.

By geographical areas, in 2021, the deficit in the balance of goods was generated by over 70% by intra-EU trade, and approximately 30% with Asian countries. The countries with which Romania had the largest trade deficits were China (3800 million euros), Austria (2700 million euros), Poland, and the Netherlands.

In 2022, the increase in the current account deficit (by 53%) was generated by the growth of the negative balances of goods and of primary income, while the sub-accounts of services and secondary income had increasing surpluses.

Thus, the deficit of the primary income balance increased by 77%, mainly due to the rise in the profit reinvested in direct investment companies in Romania, whose financial results improved, but also as a result of the increase in the volume of interest payments related to securities issued by the public administration.

The surplus of the services balance increases by approximately 38% due to the growth in receipts from telecommunications, computer and information services, road transport, construction services abroad and consulting services. The surplus of services sub-account represented 4.4% of GDP.

The surplus of the secondary income increased by 35%, in 2022, compared to the previous year, as a result of the expansion in the positive balance of other sectors (probably remittances of Romanians working abroad for periods longer than one year), and of the inflows of European funds as current transfers (European Social Fund – ESF), although Romania’s contribution to the EU budget also augmented.

Table 1 shows that, in terms of the balances of the corresponding sub-accounts (Compensation of employees in Primary income; workers’ remittances, recorded as Current transfers of other sectors in Secondary income, and Current transfers of General government, inflows [European funds] in Secondary income), both remittances and inflows of European funds counteracted the current account deficit, with increasing values. Also, from Table 1, it is noted that the inflows of European funds are lower than our country's contribution to the European Union budget, so, from this point of view, Romania's membership in this union of states is not advantageous.

Table 1
European Funds received and remittances of Romanian working abroad (mil. Euro)

		2017	2018	2019	2020	2021	2022	2023
Compensation of employees (primary income)	Inflows	2965	2946	3597	3234	3825	3931	4617
	Outflows	93	104	103	129	175	329	403
	<i>Balance</i>	<i>2872</i>	<i>2842</i>	<i>3493</i>	<i>3105</i>	<i>3650</i>	<i>3602</i>	<i>4214</i>
Workers’ remittances (current transfers of other sectors)	Inflows	3405	3427	4067	3840	4265	4948	5204
	Outflows	1623	1647	1936	1824	2083	2468	3024
	<i>Balance</i>	<i>1782</i>	<i>1780</i>	<i>2131</i>	<i>2016</i>	<i>2181</i>	<i>2480</i>	<i>2180</i>
Current transfers of general government (European funds)	Inflows	1135	972	1484	1985	1426	1982	2466
	Outflows (contrib. to the EU budget)	1305	1463	1805	2014	2502	2415	-

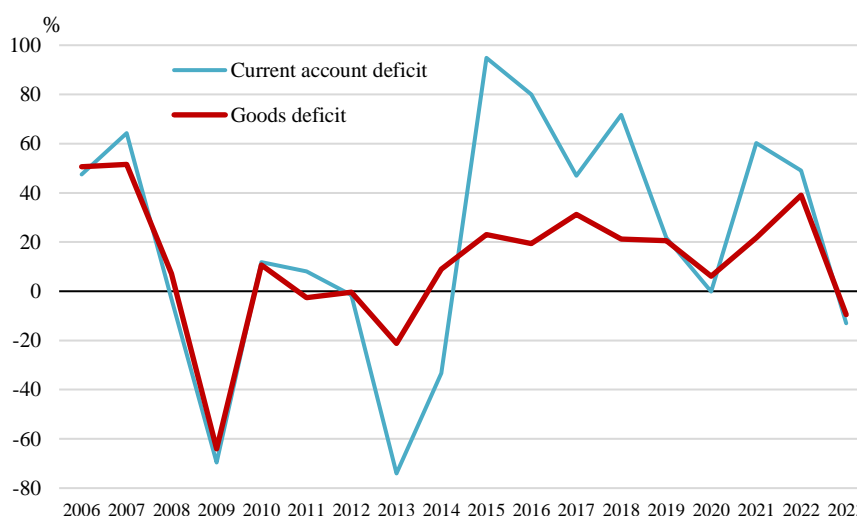
Source: NBR data

If they were spent entirely on imports, foreign capital inflows, as remittances and European funds, would have a neutral effect on the

external balance. But part of the European funds and remittances are used to purchase goods produced on the domestic market, so the effect on the balance of payments is positive, to counteract the external deficit.

The deficit of the goods balance increased by 39% in 2022 due to the higher growth in the value of imports compared to exports (see Chart 1). The explanation lies in the strong rise in prices for raw materials, gas, energy and crude oil as a result of the conflict in Ukraine, but also in the high GDP growth rate (18%), given the dependence of the Romanian economy on imports and the decrease in external demand of the European Union (in the context of low economic growth and high inflation). Slower export growth is also forecast due to the economic slowdown of Romania's main trading partners (European Union countries), thus maintaining the gap with imports and fuelling trade and current account deficits.

Chart 1
The trend of the current account and of the trade balance in Romania (annual growth rate, %)



Source: author's calculations using NBR data

Chart 1 shows that the current account balance/deficit is induced mainly by the balance/deficit of goods in Romania. It can also be noticed that the current account balance has more significant fluctuations compared to the balance of goods.

The deficit of the balance of goods was generated in 2022 in approximately 60% by two groups of commodities: chemical products and plastics (36% of the total deficit) and mineral products (24%). Other important deficits derived from base metals (11%), machinery, appliances, equipment and means of transportation (10%), textiles, clothing, footwear (9%), agri-food products (3%) and other goods (9%). In contrast, a surplus was recorded in wood and paper products (444 million euros). By geographical areas, the deficit of the balance of goods was generated in a proportion of 72.1% by intra-EU trade. (NBR, 2023).

The deficit in the agri-food sector is brought about by exports of raw materials from Agriculture, forestry, fishing and imports of processed food products.

In 2022, there is a significant deterioration in the balance of the groups of mineral products, machinery, appliances, equipment and means of transportation, and agri-food products.

In the structure of exports, six sections of the Combined Nomenclature account for 72.1% of total exports: Machinery and appliances, electrical equipment; appliances for recording or reproducing sound and images (28%), Means and materials of transportation (16%), Base metals and articles thereof (9%), Vegetable products (mainly cereals) (6.7%), Plastics, rubber and articles thereof (6%), Mineral products (5%).

Thus, around 70% of exports are intermediate goods, approximately 17% are consumer goods, and 12% are capital goods. We note that the structure of exports involves mainly goods with low added value and low processing degree, which do not offer the possibility of obtaining high prices on foreign markets and, therefore, high income from exports. In Romania, components and subcomponents are assembled or/and produced, many of which do not have high added value.

From a geographical perspective, it is found that intra-EU exports account for 72.1% of total exports, a value comparable to that recorded in 2021. The main ten export partner countries, accounting for 63.3% of total exports in 2022, were: Germany (20% of total exports), Italy (8.4%), Hungary (7.7%), France (6.1%), Bulgaria (4.1%), Poland (4%), the Netherlands (3.6%), Spain (3.3%), Turkey (3.2%), Czech Republic (2.9%). (NBR, 2023). We believe that Romania's high trade dependency on the economic evolution of the European Union countries does not support the sustainable development of the

Romanian economy, which is why we suggest a diversification of our country's trade relations.

In the structure of imports, six sections of the Combined Nomenclature account for 72% of total imports: Machinery and appliances, electrical equipment; appliances for recording or reproducing sound and images (26%), Chemical products (11%, of which 38% are pharmaceutical products), Base metals and articles thereof (10%), Means and materials of transportation (10%), Mineral products (9%), Plastics, rubber and articles thereof (7%).

We can say that Romania has mainly an intra-branch trade.

In terms of production stages, in 2022, imports of intermediate goods prevail (with 61.6% of total imports) (especially crude oil, well gas, motor vehicle parts and accessories, other raw materials with a low degree of processing for industry, subassemblies, parts and accessories, fuels and lubricants). Consumer goods represented 25.2% of total imports (medicines, cars, food and beverages for household consumption, household durables), and capital goods approximately 13% (telephone installations, data processing automatic machines, motor vehicles for the transport of goods, centrifuges, air or vacuum pumps, medical instruments and appliances, tractors, electric motors and generators, pumps for liquids). (NBR, 2023).

From the perspective of the degree of incorporated technology, measures are needed in Romania to stimulate the development of companies in technology-intensive sectors, given that our country's exports are dominated by goods with a medium to high degree of technology (medium high tech), (48% of the value of exports). Since high-value-added products (high tech) are poorly represented in total exports (7%), and imports for this type of products are substantially higher, a negative trade balance exists on this segment of goods of approximately 40% of the trade deficit generated by non-financial companies in foreign trade with goods. The authorities could also consider measures to adjust the deficit in the balance of agri-food products, including in order to ensure food security at an adequate level. (NBR, 2021).

Both in 2021 and 2022, the growth in imports came from price increases, especially for crude oil and petroleum products, electricity, and well-gas (by 60% and 84%, respectively). (NBR, 2022b; NBR, 2023).

The share of intra-EU imports in total imports of goods decreased by one percentage point compared to 2021, reaching 72.1%.

The top 10 import partner countries in 2022 (representing 67.1% of total imports) were: Germany (17.9%), Italy (7.3%), Bulgaria (7.2%), Hungary (6.7%), Poland (6.1%), China (5.9%), Turkey (4.7%), the Netherlands (4.3%), France (3.9%) and Austria (3.1%). (NBR, 2023).

In 2023, the current account deficit decreased (by 13% compared to the previous year) after eight years of continuous growth as a result of the decrease in the goods balance deficit (by 9.5%), of the very slight increase in the primary income deficit and of the increase in the surpluses of the secondary income (by 20%) and the services balance (by 1.8%).

More than half of the goods balance deficit (52.5%) came from two groups of goods: chemical and plastic products (36%) (most of which are pharmaceutical products) and mineral products (16%), a situation similar to that of 2022. Under these conditions, in order to reduce imports and, implicitly, the external deficit, we consider it necessary to take measures aimed at stimulating the domestic production of chemical and plastic products, especially the national pharmaceutical industry, through investments and innovations, in order to direct domestic demand towards domestic products.

Intra-EU trade generated 80.7% of the trade deficit, showing a high dependence of Romania's trade in goods on the economic and political evolution of a relatively small group of countries in the same geographical area.

Exports of goods were growing very little in 2023 (by 0.6%, a significantly lower rate compared to that from 2022, of 22.5%), their evolution being influenced by the moderation of the external demand, as a result of the slowdown in economic growth internationally (and especially in the EU, Romania's main trading partner), and of high core inflation, in the context of geopolitical factors that created uncertainty and led to an increase in inflation. In contrast, exports of services increased by 9.5%.

There were some consistent increases in exports from some sectors of the manufacturing industry with a high degree of technology (the most significant, by 3.5 percentage points, up to 45.1%, in machinery, appliances, equipment and means of transport), respectively reductions in the share of three groups of goods (the most significant in mineral products and base metals).

Imports diminished in 2023 (by 2%) as a result of the dependence of exports on imports, the reduction in the purchasing power of the population, but also due to the decrease in international

food and energy prices. Also, for these reasons, there were changes in the structure of imports, such as a decrease in the share of mineral products in total imports (by 3.9 percentage points, up to 8.6%), of chemical products and base metals.

The services sub-account had an increasing surplus until 2023 inclusive. The surplus in the services balance was due to the rise in receipts from telecommunications, computer and information services, goods processing services, technical and commercial services and other services for business. The largest surplus in the services balance is in telecommunications, computer and information services, road freight transport services, other services for business, and goods processing services.

The deficit in the primary income balance increased slightly, mainly as a result of the rise in the interest payments on securities issued by the general government as portfolio investments (by 65%), and of the growth in the deficit of other investments (by 96%), although the surplus in compensation of employees augmented (by 16%).

The surplus in the secondary income balance increased due to the rise in inflows of European funds in the form of current transfers (European Social Fund) (NBR, 2024).

3.2. On the sustainability threshold of the current account deficit

In the economic literature, there are several discussions regarding the sustainability threshold of the current account deficit. Many economists (Dornbusch (2002), Edwards (2005), Freund (2005) have concluded, based on studies conducted after economic crises, that a current account deficit of 4-5% of GDP is sustainable, although it does not represent a suitable criterion for assessing sustainability in itself, and exceeding this threshold can be considered a sign of crisis. Freund (2005) emphasized that there are large differences between countries regarding the sustainability threshold of the current account deficit.

In Romania, the conventional sustainability threshold of the current account deficit (5% of GDP) has been constantly exceeded during 2004-2008, making it necessary to adopt policies that should ensure the sustainability of the current account deficit in the medium and long term.

During the period 2009-2014, as a result of the reduction of population income and liquidity in the context of the increase in investors' risk aversion, the share of Romania's current account deficit

in GDP decreased considerably (compared to the previous period) (see Chart 2) (to values below the conventional sustainability threshold accepted internationally). This evolution represents a favourable element for the situation of the external equilibrium and for the Romanian economy as a whole, although it is caused by an exogenous factor, namely the international economic and financial crisis. Since 2015, the share of the current account balance in GDP has been on an upward trend, following the recovery of the national and international economy, with Romania's economy still having structural deficiencies. This trend can be explained by the consistent deterioration of the balance of goods as a share of GDP in the period 2015-2022 (see Chart 2) and the deficit of the investment income balance. In 2020, the share of Romania's current account deficit in GDP reached the conventional sustainability threshold (5% of GDP) again, and in the following years, it exceeded it.

Chart 2
The share of the goods deficit and of the current account deficit in GDP in Romania (%)



Source: author's calculations using NBR data

The unsatisfied domestic demand at the national level is the main cause of the evolution of the current account balance, and it requires the adoption of economic restructuring measures in order to manufacture in the country some of the necessary goods, which are currently imported.

4. Conclusions

Romania has experienced an external imbalance since 1990, which represents one of the main vulnerabilities of the national economy. The research shows that the external deficit is determined by the negative balance of the current account and, within it, by the negative balances of goods and primary income, and it is partially offset by the surpluses of the balances of secondary income and services. Both remittances and inflows of European funds offset the current account deficit during the period under review.

The evolution of the balance of goods was determined by the faster increase in imports compared to exports in the context of an unsatisfied domestic demand at the national level, especially for consumer goods, but also by the existence of structural problems in the Romanian economy, among which the most important are the increased dependence of consumption and exports on imports, the low level of development of the agri-food sector, the high share of energy-intensive sectors, the emigration of the workforce (leading to an inappropriate qualification of the workforce at the national level) and low energy efficiency. In this context, it is necessary to adopt measures to restructure the economy in order to make in the country some of the necessary goods, which are currently imported, especially by supporting the development of the agri-food sector, including in order to ensure food security at an adequate level.

The structure of exports involves mainly goods with low added value and low processing degree, which do not allow obtaining high prices on foreign markets, and implicitly high income from exports. Therefore, we consider that there are necessary measures to stimulate the development of companies in sectors intensive in technology.

Given the structure of imports, we consider it necessary to stimulate the national pharmaceutical industry through investments and innovations in order to orient domestic demand towards domestic products, with effects including the decrease of the external deficit.

The analysis shows that there is a high dependence of Romania's trade in goods on the economic and political evolution of a relatively small group of countries, located in the same geographical area, namely the European Union member states. The economic slowdown and high inflation in recent years in these economies are the cause of the slower growth of Romanian exports. In this context, we consider that Romania's high trade dependency on the economic evolution of the European Union countries does not support the sustainable development of the Romanian economy, and it is even risky for the evolution of the external equilibrium of our country, which is why we suggest diversification of our country's trade relationships.

Furthermore, it is noted that the inflows of European funds are lower than our country's contribution to the European Union budget, so, from this point of view, Romania's membership in this union of states is not advantageous. There is an almost continuous deterioration of the goods and current account balances as a share of GDP in the context of an almost continuous increase in GDP (except for 2009 and 2020, as a result of the economic and financial crisis of 2008 and the COVID-19 pandemic of 2020). The evolution in 2020, when external demand decreased, supply chain blockages occurred, and economic activity contracted, shows the significant dependence of the Romanian economy on external demand but also on imported products (finished and raw materials), which should constitute alarm signals regarding the structure of our country's economy.

References

1. Dornbusch R. (2002), A primer on emerging-market crises. In: S. Edwards, and J.A. Frankel (eds), *Preventing Currency Crises in Emerging Markets*. University of Chicago Press.
2. Edwards, S. (2002). Does the Current Account Matter? In: S. Edwards, and J.A. Frankel (eds), *Preventing Currency Crises in Emerging Markets*. University of Chicago Press.
3. Edwards, S. (2005). The End of Large Current Account Deficits, 1970-2002: Are There Lessons for the United States? NBER Working Paper Series, 11669(October).
4. Freund C. (2005). Current account adjustment in industrial countries, *Journal of International Money and Finance*. 24(8).
5. NBR (2021). Financial Stability Report 2020. Year VI(XVI), 11(21). New series. December.
6. NBR (2022a). Financial Stability Report 2021. Year VII(XVII), 13(23). New series. December.

7. NBR (2022b). Romania's Balance of Payments and International Investment Position Romania's Balance of Payments and International Investment Position Annual Report 2021.
8. NBR (2023). Romania's Balance of Payments and International Investment Position Romania's Balance of Payments and International Investment Position Annual Report 2022.
9. NBR (2024). Annual Report 2023. National Bank of Romania.

Sources for data:

- *** Annual Reports, 1991-2023, National Bank of Romania
- *** Monthly Bulletins, December (1991-2010; 2015-2023), January (2012-2015), August (2013, 2024), National Bank of Romania.
- *** Balance of payments and the international investments position of Romania, Annual Reports 1999-2022. National Bank of Romania.