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Dynamics of public debt service in the context of Romania's current financial crisis

Mariana Mana, Maria Macris*, Ileana Sorina (Rakos) Boca

Abstract

In the larger context of national economic policies, Romania has to ensure that both the level and the growth of public debt are sustainable, and that debt service can be provided under various circumstances while observing the objectives of cost and risk. It is also necessary to maintain public debt along a sustainable trend and to implement a credible strategy in order to reduce debt level in case it is excessive. In this context, the hereby paper attempts to analyze an important index of public debt, namely public debt service and to further identify the dominant part held by the two components of government debt service—internal governmental public debt service and external governmental public debt service—which are crucial when managing public debt under the circumstances of the current financial crisis.

Keywords: Public debt service, internal governmental public debt service, external governmental debt service, financial crisis;

1. Introduction

In 2008, global economy entered the most important economic crisis after the Great Recession of the 1930s. The crisis was highly synchronized and affected both developed countries and emergent countries, emphasizing the significant increase of interdependence among world economies. Beginning with the last quarter of 2008, financial crisis rapidly spread in Romania too, in the context of an increasingly globalized world economy, and specifically, of a Romanian economy highly integrated within the EU’s economy; accordingly, all negative external shocks quickly spread at an internal level. Despite the diminished fiscal budget environment which was the result of the expansionist macroeconomic policy of the previous years, the government promptly reacted both in 2009 and in 2010 and implemented an anti-crisis program resulting in a series of consistent measures of stabilizing the economy and of resuming the process of economic growth (Daianu & Lungu, 2008).

The impact of public debt on national economy requires a complex analysis that correlates the issue of the public deficit with government expenditures, fiscal incomes, and public debt. The more a state registers increasing budget deficits, the higher debt level is; consequently, the service of public debt can be hardly covered (Bacescu & Fota, 2009). Given the current crisis, the International Monetary Fund is back in the spotlight as the main financing entity world-wide. With each new financial crisis, public debt management should develop new mechanisms aimed at...
reconfiguring public debt instruments, monitoring the external debt of the private sector, macroeconomically integrating public debt strategies and management techniques capable of anticipating the inherent risks deriving from the process of public debt management (Dascalu, 2008).

2. Approaching certain theoretical issues that regard governmental public debt and the service of governmental public debt

The conceptual principles of public debt are defined as representing "all due gross debts at the end of the year, at their face value, belonging to public administrations, except liabilities whose financial assets are held by public administration" (Dascalu, 2008), in accordance with article 1, paragraph (5) of (EC) Regulations no. 479/2009 of the Council, dated May 25th, 2009 regarding the Protocol concerning the procedure referring to excessive deficits, annexed to the Treaty establishing the European Communities, republished. Governmental public debt is determined by "the financial needs of the State that prove to have a permanent character" (Calin, 2006). These needs are covered by the State’s revenues collected from taxes and other contributions. State’s incomes and the chance of getting them are hardly ever high enough in order to cover all the expenditures of a financial year. This resource failure leads to the occurrence of budget deficits whose coverage is achieved through internal or external loans.

**Governmental public debt** represents all financial obligations of the State, at a certain moment, originating in refundable financing directly contracted or guaranteed by the Government on financial markets.

Important indices of the analysis of public debt are the following ones: the **service of public debt**, the **service of internal governmental public debt** and the **service of external governmental public debt**. The **service of public debt** includes all amounts consisting in capital installments at maturity, paid interests, commissions and other costs related to the public debt originating in refundable financing concluded according to contracts or guaranteed by the Government through the Ministry of Finances. **A country’s indebtedness**, at a specific moment, is determined by relating the balance of public debt to gross domestic product. Indebtedness represents an analysis index that shows how much they should take out of the gross domestic product during a certain year in order to fully repay the debt in that specific year. The more the repayments of loans, interests, and their related charges absorb higher amounts out of export incomes, the more tensioned the balance of external payments of a country indebted to foreign countries is. We consider that, under the circumstances of contracting new loans, Romania's public debt ratio is going to increase; nevertheless, it will further range below the 60% margin of GDP settled by the Treaty of Maastricht (Treaty on European Union, 1992). We should mention that for Romania the amount of public debt is a convergence criterion with a view of adopting the Euro. In addition, to the country’s indebtedness to foreign countries one should add the financial and foreign currency burden determined by external public debt that shows the debt burden during the specific year. The financial and foreign currency burden sourced in the external public debt is displayed by the service of external public debt. Romania is a moderately indebted country whose external indebtedness is well below the maximum allowable margin. The sustainability of external public debt is best shown by the index called "ratio of debt service" which is the ratio between the service of external public debt and the exports of goods and services. Romania’s management of public debt aims both at diminishing the cost of public debt service and at lowering the risks connected with the portfolio of governmental public debt (Holt, 2009). The risks associated with the portfolio of governmental public debt are the following ones: market risk, refinancing risk, liquidity risk, credit risk, settlement risk and operational risk. Public debt management consists in conceiving a strategy of managing State’s debt capable of providing the amounts required by financing, of achieving the risk and cost objectives set by the authorities, and of carrying out the other objectives set by them, such as the development and maintaining of a performing government securities market.
3. Analysis and findings regarding the evolution of Romania's service of governmental public debt during the period 2001 - 2010

The hereby research has focused on determining the dynamics and evolution of Romania's service of governmental public debt as well as on outlining its evolution. Accordingly, during the period 31/12/2001 – 31/12/2010, Romania's service of governmental public debt displayed the evolution exhibited by Table 3.1.

Table 3.1. Service of governmental public debt during the period 2001 - 2010

| Year | Service of governmental public debt (million Lei) | Service of internal governmental public debt (million Lei) | Service of external governmental public debt (million Euro denominated in million Lei) | Gross domestic product (million Lei) | Share of the service of governmental public debt within GDP (%) | Expenditures of general consolidated budget (million Lei) | Share of the service of governmental public debt within total expenditures of general consolidated budget (%) |
|------|-----------------------------------------------|--------------------------|---------------------------------|---------------------------------|---------------------------------|--------------------------------------------|--------------------------------------------------|
| 2001 | 22,848.9                                      | 17,537.4                | 5,311.5                        | 116,768.7                       | 19.6                            | 38,932.1                    | 58.7                                              |
| 2002 | 25,678.3                                      | 18,481.3                | 7,197.0                        | 151,475.1                       | 17.0                            | 50,728.2                    | 50.6                                              |
| 2003 | 24,533.5                                      | 17,734.1                | 6,799.4                        | 197,600.0                       | 12.4                            | 62,372.9                    | 39.3                                              |
| 2004 | 22,066.6                                      | 14,625.5                | 7,441.1                        | 246,400.0                       | 9.0                             | 80,106.4                    | 27.5                                              |
| 2005 | 13,594.6                                      | 6,412.1                 | 7,182.50                       | 288,995.0                       | 4.7                             | 92,660.1                    | 14.7                                              |
| 2006 | 12,304.0                                      | 5,998.8                 | 6,305.20                       | 344,651.0                       | 3.6                             | 116,049.7                   | 10.6                                              |
| 2007 | 10,405.1                                      | 4,819.5                 | 5,585.60                       | 412,762.0                       | 2.5                             | 147,141.2                   | 7.1                                               |
| 2008 | 14,278.5                                      | 6,521.1                 | 7,757.40                       | 514,654.0                       | 2.8                             | 190,340.2                   | 7.5                                               |
| 2009 | 56,900.6                                      | 51,122.9                | 5,777.70                       | 491,273.7                       | 11.6                            | 193,679.3                   | 29.4                                              |
| 2010 | 46,000.0                                      | 37,500.0                | 8,500.0                        | 513,641.0                       | 9.0                             | 201,900.0                   | 22.8                                              |
| Total| 248,610.1                                     | 180,752.7               | 68,857.4                       | -                              | -                              | -                            | -                                                 |

Source: Ministry of Finances and the authors ‘own calculations

The analysis of the above data shows that during the period 2001 - 2010, Romania paid a service of governmental public debt representing 248,610.1 million Lei, namely, 67,248.92 million Euro (in case of Euro amounts we have employed the average annual exchange rates of the period 2001 - 2010 provided by RNB), an average of 2,071.83 million Euro a year. One may notice that during the analyzed period the service of governmental public debt had a fluctuating evolution. The highest level of the service of governmental public debt was achieved in 2009 when it reached the value of 56,900.6 million Lei. The hereby research highlights the fact that while in 2009 the expenditures of the general consolidated budget increased by 1.75% and gross domestic product decreased by 4.55%, as compared with 2008, the service of governmental public debt had an alarming 398.5% increase; afterwards, in 2010, it dropped by 19.16% as compared with 2009, under the circumstances of a 1.04% increase of the expenditures of the general consolidated budget and of a 4.55% increase of gross domestic product.

The structure of the service of governmental public debt during 2010 was as follows: 44,700 million Lei represented the service of the governmental debt directly contracted by the State and 1,300 million Lei represented the service of governmental debt guaranteed by the State. Out of the total amount of the service, 39,000 million Lei represented repayments of capital installments (including the refinancing of government securities) and 7,000 million Lei were paid as interests and fees. The decrease of the debt service contracted on the domestic market by 13,600 million Lei as compared with that of 2009 was mainly due to the lower refinancing amount of government securities of 31,500 million Lei as compared with 47,000 million Lei in 2009. Another index of the service of governmental public debt was the service of external governmental public debt / exports of goods and services which represented 3.8% in 2009 and 4.6% in 2010. This index shows the extent to which the payments of the service of external governmental public debt are covered by the revenues from goods and services exports.
4. Findings regarding the evolution of the service of internal governmental public debt and of the service of external governmental public debt

The hereby research shows that the evolution of the service of internal governmental public debt was similar to that of the service of governmental public debt displayed by Table 3.1.

Table 4.1. The evolution of the service of internal governmental public debt during the period 2001 – 2010

| Year | Service of internal governmental public debt (million Lei) | Repayment of loans * (million Lei) | Interests and fees (million Lei) | Share of the service of internal governmental debt within GDP (%) | Share of the service of internal governmental public debt within total expenditures of general consolidated budget (%) |
|------|---------------------------------------------------------|-----------------------------------|----------------------------------|---------------------------------------------------------------|--------------------------------------------------------------------------------|
| 2001 | 17,537.4                                                | 14,755.5                          | 2,781.9                          | 15.02                                                         | 45.05                                                                            |
| 2002 | 18,481.3                                                | 16,450.3                          | 2,031.0                          | 12.20                                                         | 36.43                                                                            |
| 2003 | 17,734.1                                                | 15,995.4                          | 1,738.7                          | 8.97                                                          | 28.43                                                                            |
| 2004 | 14,625.5                                                | 13,525.8                          | 1,099.7                          | 5.94                                                          | 18.26                                                                            |
| 2005 | 6,412.1                                                 | 5,233.1                           | 1,158.8                          | 2.22                                                          | 6.92                                                                             |
| 2006 | 5,998.8                                                 | 5,528.3                           | 470.5                            | 1.74                                                          | 5.17                                                                             |
| 2007 | 4,819.5                                                 | 4,151.5                           | 668.0                            | 1.77                                                          | 3.28                                                                             |
| 2008 | 6,521.1                                                 | 5,060.5                           | 1,460.7                          | 1.27                                                          | 3.43                                                                             |
| 2009 | 51,122.9                                                | 47,275.2                          | 3,847.7                          | 10.41                                                         | 26.40                                                                            |
| 2010 | 37,500.0                                                | 31,695.4                          | 5,804.6                          | 7.30                                                          | 18.57                                                                            |

* Government securities refinancing is included
Source: Ministry of Finances and authors’ calculations

During the analyzed period the service of internal governmental public debt had a fluctuating evolution. The highest level of the service of internal governmental public debt was attained in 2009 when it reached 51,122.9 million Lei. One may notice that in 2009 Romanian State incurred a huge financial effort representing 51,122.9 million Lei which was determined by the payment of the service of internal governmental public debt that displayed a tremendous increase of about eight times as compared with that of 2008. In 2010, the service of internal governmental public debt decreased by 26.65% as compared with 2009. As regards the share of the service of internal governmental public debt within GDP, it decreased from 45.05% in 2001 to 3.28% in 2007; afterwards, it increased to 26.40% in 2009 and decreased to 7.30% in 2010. The same condition is displayed by the share of the service of internal governmental public debt within total expenditures of the consolidated general budget which decreased from 15.02% in 2001 to 1.17% in 2007, increasing afterwards to 10.41% in 2009 and subsequently decreasing to 18.57% in 2010. One of the factors exerting a major influence upon the country’s foreign exchange condition is the service of external governmental public debt which represents the sum of the payments of capital installments and of the payments of interests and commissions towards foreign creditors (The Ministry of Public Finance, 2011). The evolution of this index during the analyzed period is displayed by Table 4.2.

Table 4.2. Service of external governmental public debt during the period 2001 - 2010

| Year | Service of external governmental public debt (million Euro) | Repayments of external loans (million Euro) | Interests and commissions afferent to external loans (million Euro) | Share of the service of external governmental public debt within external governmental public debt (%) | Share of the service of external governmental public debt within GDP (%) | Share of the service of external governmental public debt within exports of goods and services (%) | Share of the interests and commissions afferent to external governmental public debt within exports of goods and services (%) |
|------|------------------------------------------------------------|---------------------------------------------|---------------------------------------------------------------|-------------------------------------------------|-------------------------------------------------|---------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|
| 2001 | 2,040.7                                                    | 1,544.9                                     | 495.9                                                        | 23.14                                           | 4.55                                            | 13.61                                                                      | 3.31                                                                                       |
| Year | Capital Repaid | Capital Interest | Total Interest | Total Payment | Total Interest % | Total Payment % |
|------|----------------|-----------------|---------------|--------------|-----------------|----------------|
| 2002 | 2,302.7        | 1,791.9         | 510.8         | 25.10        | 13.43           | 2.98           |
| 2003 | 1,810.5        | 1,288.6         | 521.9         | 18.79        | 3.44            | 9.90           |
| 2004 | 1,835.9        | 1,319.1         | 516.8         | 17.88        | 3.02            | 8.41           |
| 2005 | 1,982.3        | 1,448.6         | 533.7         | 18.11        | 2.49            | 7.52           |
| 2006 | 1,789.0        | 1,225.9         | 563.1         | 17.77        | 1.83            | 5.69           |
| 2007 | 1,673.7        | 1,115.0         | 558.7         | 17.63        | 1.51            | 4.59           |
| 2008 | 2,106.5        | 1,560.5         | 546.0         | 21.21        | 1.51            | 4.96           |
| 2009 | 1,365.5        | 905.8           | 457.7         | 11.06        | 1.18            | 3.77           |
| 2010 | 1,986.0        | 1,705.1         | 280.9         | 10.08        | 1.70            | 4.60           |
| Total| 18,350.7       | 13,214.3        | 5,136.4       | -            | -               | -              |

Source: Ministry of Finances and authors’ calculations

It appears that, during the analyzed period, the service of external governmental public debt had a fluctuating evolution. During the ten years in consideration, the financial exchange burden determined by repaying capital rates and the payment of interests and charges afferent to the external governmental public debt represented 18,350.7 million Euro. Under such circumstances, the share of the service of external governmental public debt within external governmental public debt as well as the share of the service of external governmental public debt within GDP displayed the same fluctuating evolution. As regards the share of the service of external governmental public debt within the exports of goods and services, one may notice that it exhibited a descendant trend during the analyzed period; accordingly, it dropped from 4.55% in 2001 to 1.70% in 2010. The same descendant trend could be seen when dealing with the share of interests and charges afferent to external governmental public debt within the exports of goods and services; accordingly, the share decreased from 3.31% in 2001 to 0.69% in 2010. Such circumstances were determined by the significant decrease of the exports of goods and services in Romanian economy that had a negative impact on the process of economic growth.

5. Conclusions

In order to make clear the researched phenomenon we have employed a significant amount of statistical data with a view of analyzing Romania's service of governmental public debt during the period 2001-2010; the data have therefore highlighted the main tendencies of its evolution which influence the measures envisaged in order to continuously improve public debt management which, at its turn, contributes to the elaboration of public debt management strategy. Our research has attempted to emphasize the main aspects that determine the drawing out of certain fiscal measures capable to diminish the continually growing budget deficit and to decrease the level of governmental public debt that would make the service of public debt more easily manageable. Within the broader context of national economic policies, Romania has to ensure that both the level and the growth rhythm of public debt are sustainable, and that the service of public debt can be provided under various circumstances while observing cost and risk objectives. It is also necessary to maintain public indebtedness along a sustainable path and to implement a credible strategy capable to reduce debt levels in case they are excessive.

According to the above assumptions we should also point out that the objectives of the management of governmental public debt during the period 2008 - 2010 set out by strategy had in view the controlled increase of governmental public debt, the decrease of medium and long term governmental public debt costs, the limiting of the risks afferent to the governmental public debt portfolio, and the development of government securities market.

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