ROMANIA'S EXTERNAL DEFICIT. INTERNAL CONDITIONS

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Abstract: *Starting with 1990, the year at the beginning of the transition to the market economy, and up to the present moment, regardless of the dynamics of economic growth, Romania has constantly recorded external deficits. There are a large number of internal and external factors that directly or indirectly influence the level and evolution of a country's external deficit, among the most important being the evolution of the gross domestic product, trade relations including exports and imports, the level of prices for raw materials, oil, gas and energy, internal and external inflation, the budget deficit, the level of public and private debt, foreign direct investments, remittances, etc. An increased external deficit in the long term can become a big problem because it is transferred to the external debt of the state and from a certain level and under certain conditions it can become unsustainable. The current work aims to analyze the specific internal conditions at the level of 2023 that influence the evolution of Romania's external deficit.*

Keywords: *current account, trade balance.*
JEL Classification: *E60, H60.*

1. Introduction

Apart from the external constraints arising from the economic and political developments worldwide, but also at the level of the European Union, there are certain internal conditions specific to Romania that are challenges for finding the best methods of avoiding certain risks and making the most of existing opportunities.

The main characteristics of Romania's economic situation at the beginning of 2023, namely: Persistent budget deficit; Current account deficit, among the largest among EU countries, relative to GDP; Smaller exports than imports, exports of products with little added value; Increased costs for energy, methane gas, raw materials and materials; Very high inflation rate, one of the highest in the European Union; External debt approaching the 50% threshold, but increasing; Debt service growing, among the highest at European level; Foreign direct investments that have reached the 100 billion euro mark; Romania annually receives capital from the European Union in the form of structural funds to which are added the amounts received through the "PNNR - National Recovery and Resilience Plan".

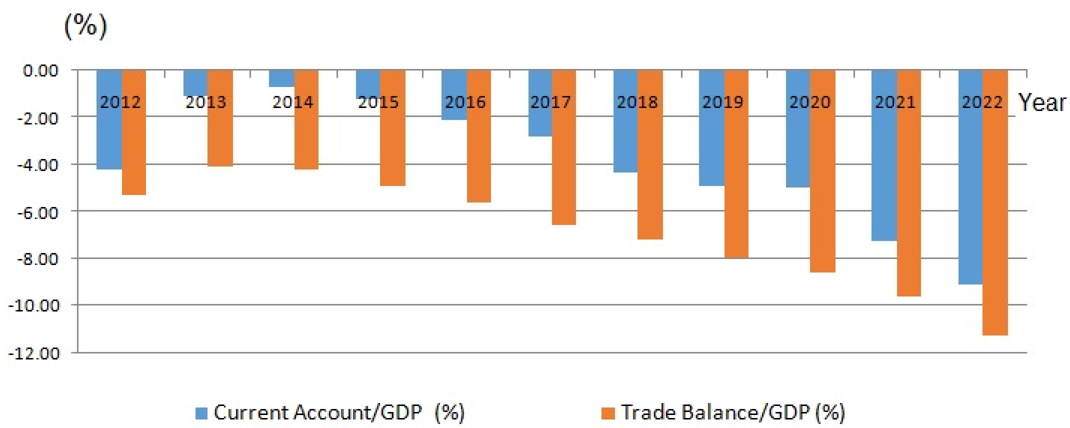
All these factors have a direct or indirect influence on the current account balance and the external balance of Romania.

2. Findings

The chronic budget deficit is due to the inadequacy of budget expenditures to the level of budget revenue collections. On the one hand, Romania is a country with a low level of taxation at the European level (this is in accordance with the degree of economic development, developed countries can afford a high level of taxation), and on the other hand there is the lingering problem of the level of tax collection. At the same time, the expenses are higher than we can afford (not consistent with the available income). Governments have permanently favored spending on salaries, pensions, social benefits to the detriment of public investments in infrastructure. This is a double-edged sword. If infrastructure investment can boost economic growth, higher wages lead to economic growth through consumption. This type of development is not the most economically sound and cannot work indefinitely. At the same time, the increased salaries from the budget system also raised salaries from the private sector, reducing the productivity and profitability of companies. It is known that the salary difference between the countries of Eastern Europe and those of the West is one of the factors that attract foreign investments. (A positive effect of the increase in domestic wages compared to existing wages in developed countries was the reduction of the loss of labor force that emigrates for economic reasons. It is known that the domestic labor market cannot supply labor force to the existing demand neither in structure nor in level of At the national level, there is a lack of labor force, the aging of the population and the need to bring in labor force with a certain qualification from abroad.

When the growing domestic demand cannot be satisfied by products from the domestic market, the demand for imported products increases.

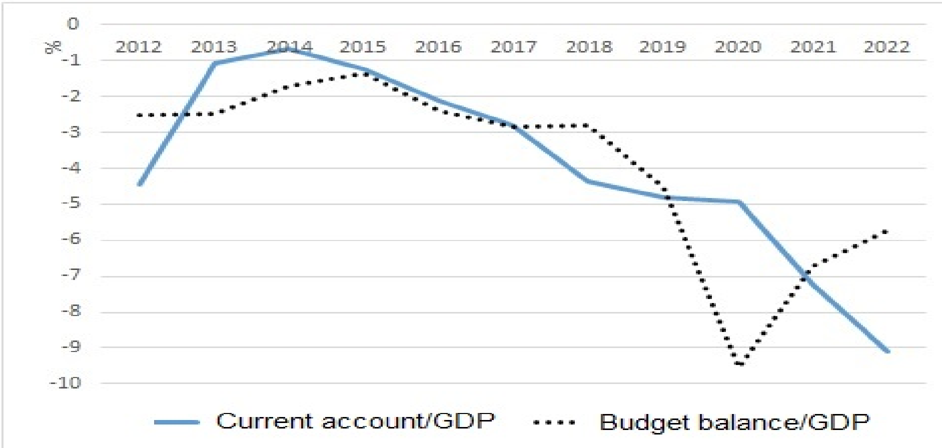
Chart no.1. The evolution of the trade balance and the current account deficit in Romania (% in GDP)



Source: BNR data and the author' calculations

As can be seen from graph no. 1, the trade balance and the current account have registered a constant deficit throughout the last ten years, with lower values in the first years, especially due to the budgetary restrictions imposed by the IMF (especially the 25% reduction in wages and the increase of VAT), but in constant growth from 2014 to 2022, due to the increase in budget expenditures and salaries.

Chart no. 2. The evolution of the budget balance and the current account deficit in Romania (% in GDP)

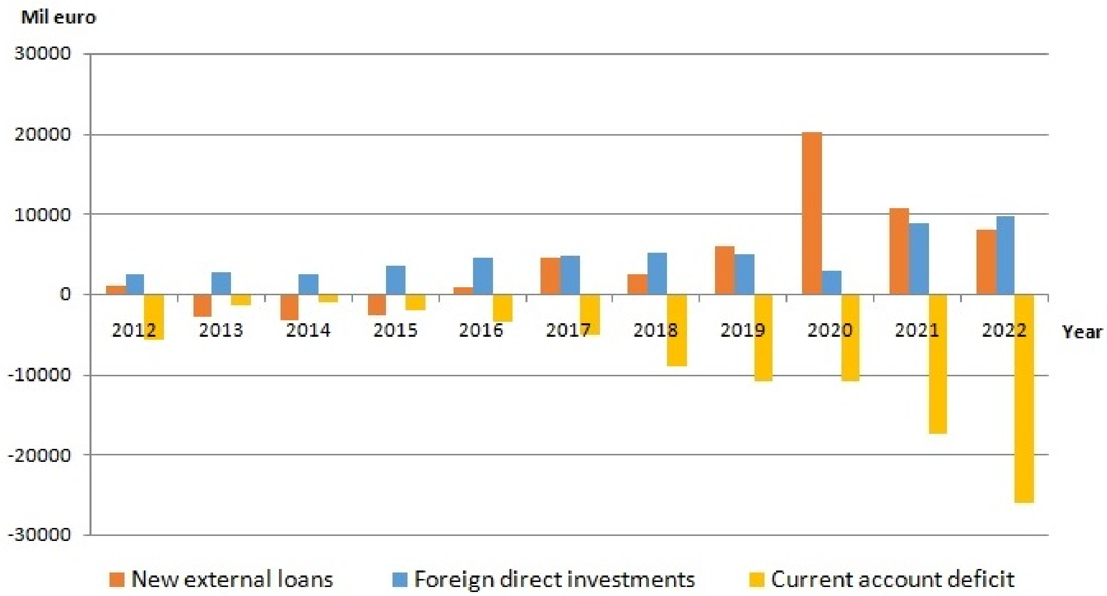


Source: BNR data and the author' calculations

The twin deficits. Romania has a large current account deficit, which is on an almost continuously increasing trend, budget deficit with a worsening trend in recent years (caused by expenses that cannot yet be reduced and insufficiently collected revenues). From graph no. 2 it can be seen that the two indicators have a similar trend in most years of the analyzed period, they are in a relationship of positive interdependence.

The budget deficit is covered with loans. When loans are taken from the domestic market, the savings in the banks diminish, and the amounts left at the disposal of the firms are smaller, with more restrictive conditions and higher interest rates. If the amounts collected from the domestic market are not sufficient, external loans are used. Most of the time, external loans are more difficult to obtain due to the conditions imposed by the lenders, the risk aversion of the lenders, and the greater competition for obtaining the necessary funds. Part of the budget deficit is transferred to the current account deficit, according to the twin deficit equation.

Chart no. 3. The evolution of the current account deficit, foreign direct investments and new external loans in Romania (2012-2022)



Source: BNR data and the author' calculations

As can be seen from graph no. 3, the current account deficit has registered a constant deficit throughout the last ten years. This deficit must be covered from different sources, especially with foreign direct investments, remittances from those who went to work abroad and external loans. Obviously, foreign direct investments are preferable because through their effect, goods and services are created that lead to an increase in exports and a decrease in imports in the future, thus balancing the trade balance in the future. Remittances had their place in supporting domestic consumption and consumption-based economic growth, with billions of euros being sent from abroad year after year. However, as the current account deficit is increasing year by year and is not covered by direct foreign investments and remittances, the state is forced to borrow more and more from abroad, creating a large, rapidly growing external debt with high interest from the cause of the world situation and the way the country's creditworthiness is assessed by external creditors through the ratings given in the country rating by the major rating agencies. This external debt is increasingly difficult to bear, and in the long term there is a risk of becoming unsustainable, and its rollover from year to year becomes difficult due to the increase in the interest paid.

The trade balance is in deficit, the value of exports being greater than the value of imports of goods, even if exports of services exceed imports. The problem is the structure of domestic production of goods that fails to cover domestic demand. At the same time, exports do not contain goods with high added value, goods that incorporate a high technological level.

There are also problems of not exploiting the internal potential, for example, the agricultural potential is not exploited through intensive agriculture and on large areas (small quantities are difficult to contract for the distribution chains or exporters), so that although Romania has obvious competitive advantages (areas of vast land, climate, soil quality, hydrographic network, etc.), agricultural products contribute to the current account deficit. A somewhat similar situation is registered in the case of tourism. Due to the inadequacy of current tourism requirements, Romania is wasting its tourist potential, so that year after year the sums spent by Romanians in other countries for tourism purposes are considerably higher than those left by foreign tourists in Romania.

Following the war in Ukraine, the prices of energy and methane gas, but also of raw materials and materials, increased significantly. This determined worldwide and in Romania an increase in prices, which was transmitted to the economy in all fields, in certain cases certain companies dependent on imported raw materials had to temporarily or permanently stop their activity, (see the case of Azomures, a large producer of agricultural fertilizers, which temporarily stopped the activity due to the increased price of methane gas, the fertilizers needed domestically being then imported at much higher prices). The increased prices for methane gas, oil, mineral oils and other raw materials put even more pressure on the current account. Governments (including the Romanian one) have decided to subsidize the price of electricity and methane gas, creating additional pressure on the state budget. The increase in the price of goods and services has led to the need for wage increases in both the public and private sectors to keep pace with inflation. Increased incomes generated additional demand which in turn contributed to higher inflation. The BNR acted simultaneously with the other national banks of the EU countries, by increasing the reference interest rate, which tightened domestic lending, and since the middle of the previous year the inflation rate has been on a downward slope.

The proximity of the conflict in Ukraine also has influences on obtaining the necessary external financing, by tightening credit conditions as a result of the increase in risk aversion of investors.

A high inflation rate always benefits the borrower but only for a short period of time by eroding the value of the loan. Thus, the state is also advantaged by internal and external inflation in eroding the value of the amounts owed. But subsequent loans will be contracted at increased interest rates that will make it difficult to repay them. Romania's debt level has already reached almost 50%, (this being a psychological threshold, an alarming threshold), and the interest rate at which Romania borrows is very high, the highest in the European Union next to Hungary. Interest payments for the return of loans already contracted, but also for new loans needed to cover the current account deficit or the budget deficit, at increased interest rates could become burdensome for the country's budget.

The current account deficit is also deepened by military spending which must reach 2.5% of GDP according to the commitments assumed. Because the military industry has shrunk with the loss of external markets with traditional partners after 1990, and with the entry into NATO the interoperability needs made us have to import military equipment from NATO partners, which made the military industry local to disappear completely. Very little of the military equipment imports were conditioned by offset work (maintenance and repair) in the country.

The current account deficit is also covered by the remittances of those who have gone to work abroad and have families in the country, direct foreign investments but also the funds received from the European Union in the form of structural funds or through PNRR - the National Restructuring and Resilience Plan. Foreign direct investments, although they have reached the value of 100 billion euros as a stock, are small compared to those of other countries in Eastern Europe (Czech Republic, Hungary, Poland), the reasons why we fail to bring more investors are various: lack of infrastructure, bureaucracy, the thick legislative framework and frequent changes to which the lack of manpower in the necessary structure and specialization is added more recently. It should be added that compared to the mentioned countries, we have a time gap from the time of accession to the European Union.

3. Conclusions

The current account deficit is a chronic problem of the Romanian economy, which has worsened in recent years amid global crises. Even if some of the existing economic conditions worldwide have improved, (we are referring in particular to the drop in the price of raw materials, oil, natural gas and energy and to the sustained economic growth in the USA but also at the global level), Romania will it had a current account deficit in the following years, which will gradually decrease.

In order to achieve this objective, it is necessary for the government to take a package of measures that include budget policies (increasing budget revenues by increasing collection, reducing budget expenses, by making the budget apparatus more efficient and reducing its expenses, orienting expenses towards infrastructure investments which would attract as much foreign direct investment as possible, (it is known that the lack of a developed road and railway infrastructure has often led to billions of investments being directed to other neighboring countries with modern infrastructure), or investments through which the untapped potential of the country is brought to fruition in certain areas such as tourism or agriculture), monetary policies (especially the interest rates set by the national bank), exchange policies through which a certain exchange rate of the national currency can encourage exports and decrease imports, and even use C @tariff barriers for products imported from abroad European Union.

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