THE CURRENT ACCOUNT OF ROMANIA – EVOLUTION, FACTORS OF INFLUENCE, FINANCING

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Abstract

The balance of the current account is a tool used to establish the level of economic development of a country, its international specialization and its degree of dependence on foreign markets. Based on the analysis of a few indicators considered relevant by the author, the article[9] aims to present the evolution of Romania's current account balance and of its components during the period 2005-2013, showing the determinants, and highlighting the extent to which the crisis has been one of the factors influencing Romania's current account. Also, the ways of financing Romania's current account deficit will be analysed, highlighting the advantages and disadvantages of this type of financing.

Keywords: incomes, services, deficit, financing, investment, foreign loans and credits

JEL Classification: F14, F32, G01

1. Introduction

As it is known, the current account balance is an instrument which characterizes the level of economic development of a particular country, the international specialization of each individual economy and its level of dependence on the foreign market.

As of 2003, the current account deficit of Romania increased spectacularly and this rapid growth even questioned, at a particular moment, its sustainability.

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Although from 1997 to 2006, Romania received foreign direct investments which allowed the cover, without problems seemingly, of the negative current account balance, the long-term perpetuation of a high current account deficit is not sustainable because the large inflows of foreign direct investments don't occur continuously, on an unlimited period of time, because they depend on a multitude of factors, some of them exogenous to that particular economy. On the other hand, financing a high current account deficit through foreign direct investments is not efficient if these inflows of foreign direct investments don't increase, after a period, the exports of the recipient economy and if they don't generate added value in the economy.

The situation of the current account balance of Romania changed as of 2009 when, on the background of the international economic and financial crisis, both the deficit and the main source of financing, the foreign direct investments, decreased significantly.

2. The evolution of the current account balance and its components

In Romania, the subaccount of goods and services influences mostly the evolution and balance of the current account. Within the subaccount of goods and services, the goods (commercial balance) have the highest weight.

Monitoring the evolution of exports, imports, trade balance and current account balance we notice that 2009 is a year of breach which shows that the Romanian economy has felt the effects of the economic and financial crisis through the trade channel, the trust channel and through the effect of contagion.

The blockage of the capital markets and the strong decrease of the international financial flows forced the multinational companies to reduce their global expansion within the limit of the available financial resources and this reduced the international trade flows.

The exports of goods and services as well as the exports of goods from Romania increased throughout the analysed period, except in 2009 and 2012 for the goods. After the reduction of 2009, the Romania's exports have resumed their strong increase (except 2012).
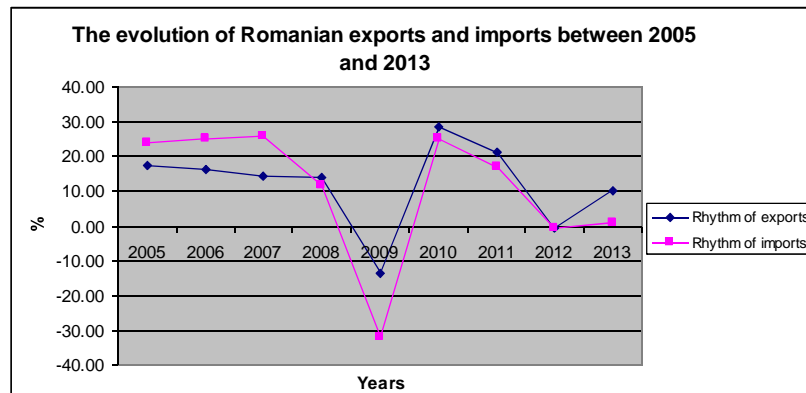
The imports have increased each year until 2008 included. The strong increase of the imports of goods noticed until 2008, in 2010 and 2011 (see Chart 1) reflects the excess of demand on the domestic market (for the final consumption of the households, for the

intermediary consumption and less for the gross formation of capital), and the real appreciation of the national currency. It is important to notice that a high level of dependence of the national economy on imports may affect the sustainable development of the Romanian economy.

The economic and financial crisis has as effect the significant decrease of the imports in 2009. Since many of the raw materials and intermediary products used in Romania are imported, this decrease affected negatively the economy: lower volumes of goods required by the manufacturing process, the activity of the economic agents contracted and the economic growth shrank. In 2010 and 2011 there was some relaxation of the situation, when the imports increased strongly on the background of the efforts to overcome the crisis.

As of 2008, the rate of increase of the imports was lower than the rate of increase of exports of goods and services, which improved the trade balance (see Chart 1).

Chart 1

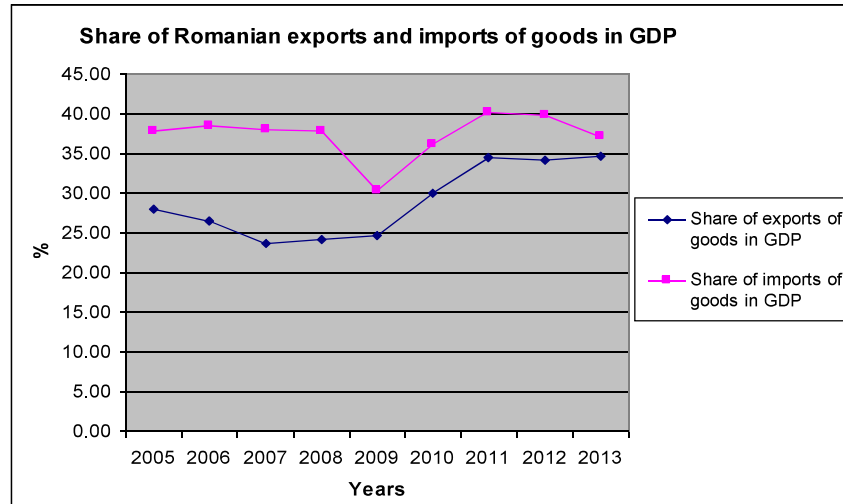*Source: author's calculations based on NBR data*

On the background of the international economic and financial crisis, which decreased the domestic and foreign consumption, as well as the national production, the negative balance of the net export decreased over the period 2009-2013, after the sharp increase from 2007-2008. The net export decreased significantly in 2013, on the background of increasing exports of goods and services, which had a much higher rate of growth than the imports of goods and services. Thus, the trade balance deficit decreased in 2013 by more than half compared to 2012, and the surplus of the services subaccount

doubled. If this situation continues, it may be considered as an evolution of the Romanian economy towards the structure of the developed economies, whose sector of services is very developed. If we analyse the structure of the services we may notice that the positive evolution of the balance of this subaccount is due mainly to the transportation services. This might seem a paradox under the conditions in which the road and railway infrastructure in Romania is still not too developed. Within this context, given the high demand for transportation though Romania, in order to capitalise this opportunity, we propose that the fast development of the road and railway infrastructure is included among the development priorities of Romania.

The modest share, less than a third, of the exports of goods to GDP (see Chart 2) shows a modest contribution of the exports to the formation of the GDP, due to the lack of a macroeconomic policy aiming to consolidate the Romanian exports, due to the incapacity of the exports to capitalise the opportunities arising from the increasing openness of the Romanian economy towards the international markets, and due to the insufficient adaptation of the industrial production to the requirements of the foreign markets. The increase of the share of exports to GDP in 2010 and 2011 can be explained by a slower rate of GDP growth due to the effects of the international financial crisis. The value from 2012 is almost equal with that from 2011, which shows, on the background of the slight decrease of the exports of goods, the economic stagnation from 2012, a worrying situation for Romania, which seems not to have yet recovered from the effects of the economic and financial crisis.

During the analysed period, the share of imports of goods to GDP exceeded constantly the share of exports to GDP (see Chart 2), which had negative effects on the trade balance and on the country's degree of indebtedness. The share of imports of goods to GDP of Romania shows that the domestic production of Romania is completed to a large extent by imports. For this indicator too, 2009 is a year of breach, when it displayed a decrease. Starting with 2009, a decreasing gap has been noticed between the share of imports and exports to GDP (see Chart 2).

Chart 2

Share of Romanian exports and imports of goods in GDP

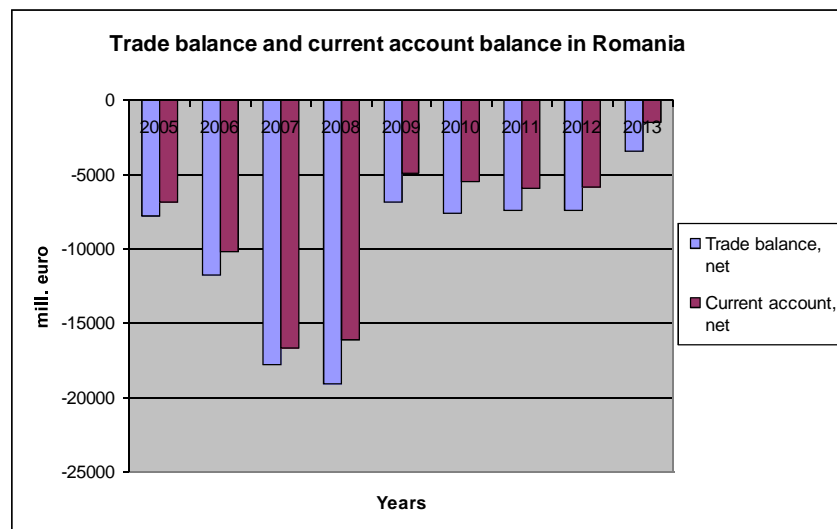*Source: author's calculations based on NBR data*

As one may notice from the evolution of the indicators shown above, the crisis of 2008 had positive effects on the trade balance of Romania. On the other hand, as the imports decreased, consumption also decreased, which shows a strong dependence of the domestic consumption on the imports. In order to avoid that the imports increase once the economy recovers, it is absolutely necessary that the domestic consumption becomes oriented towards national products, both by stimulating the Romanian producers and by an awareness-raising campaign of the Romanian consumers towards the national products.

Before the onset of the international economic and financial crisis, the situation was worrisome because the trade balance deficit was constantly increasing (see Chart 3). The increase of the trade balance deficit occurred because the dynamics of the imports was higher than the dynamics of the exports, being stimulated by the increase in the demand for consumer goods, for primary energy resources, by the pay raise and by the fast expansion of the nongovernmental credit for household long term goods. However, this situation tempered down in 2008, when due to the decrease in the volume of imports, the trade balance improved namely the rate of growth of the deficit tempered. Significant decreases of the trade

balance deficit were noticed in 2009 and 2013. The trade balance became rather stable as of 2009.

The increase of the current account deficit is explained the internal structural adjustments of the economy, by the continuation of the process of convergence and by the real appreciation of the national currency between 2005 and 2007, in 2010 and 2013. As of 2008, the balance of the current account decreased, the most significant decrease being recorded in 2013 (see Chart 3).

Chart 3

Source: author's calculations based on NBR data

The negative value of the share of the trade balance deficit to GDP shows that the deficit of the trade balance affects the domestic economic process, which calls for concrete measures in the field of macroeconomic policies in order to stop the outflow of the national income. This indicator had much lower values in 2009-2013 due to the effects of the economic and financial crisis on the foreign trade of Romania (see Chart 4).
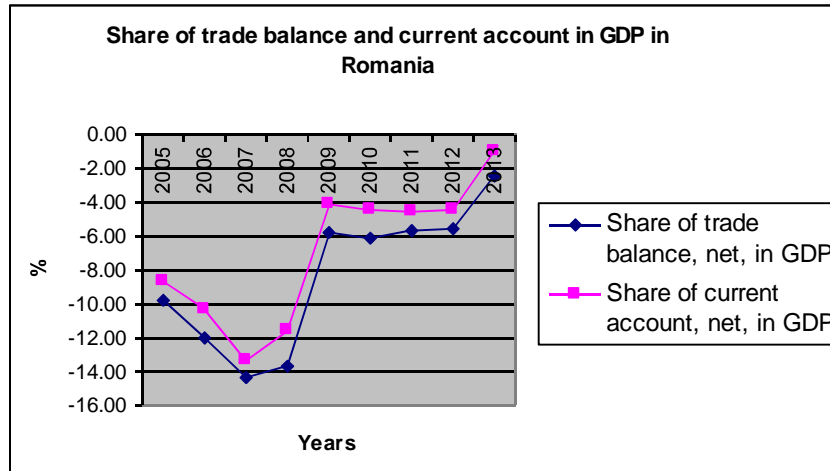
Although the share of the current account deficit to GDP exceeded the conventional threshold of sustainability of the current account deficit (5% of the GDP, according to IMF), in each year from 2004 to 2008 (see Chart 4), the value of the foreign deficit of Romania was not worrisome because its financing was ensured, particularly by inflows of foreign direct investments. Apparently, the

Romanian economy has opened towards the world much faster than it has been restructured.

Between 2009 and 2013, the share of the current account deficit to GDP was below 5% due to the effects of the economic and financial crisis, which came into Romania through the channels of trade and trust and by contagion. This evolution shows that an external factor, such as the crisis, may induce, on the short term, positive changes in the share of the current account deficit to GDP, but they are not deep long time changes.

It is necessary that the decrease of the current account deficit takes place due to the reorganisation of the economy on sustainable bases. This evolution prevents the increase of the share of the current account deficit to GDP once the world economy revives. Furthermore, it is advisable that the economy re-orientates towards fields of activity in which Romania has competitive and comparative advantages, process which should ensure the medium and long-term sustainability of the current account deficit. The evolution from 2013 shows a possible improvement of the quality of the Romanian exports and an adaptation of their structure to the foreign demands.

Chart 4

Share of trade balance and current account in GDP in Romania

Source: author's calculations based on NBR data

The analysis of the trade balance share to current account balance shows that, throughout the analysed period, the evolution of the trade balance was the cause of the current account deficit,

evolution supported by the indicator "the normed length of the vectors of structure of the current account on debit and credit" (see Table 1).

Table 1 The normed length of the vectors of structure of the current account

Indicators	2005	2006	2007	2008	2009	2010	2011	2012	2013
Normed length of the vector of structure of the current account on credit*	0.63	0.59	0.55	0.55	0.61	0.70	0.74	0.73	0.74
Normed length of the vector of structure of the current account on debit **	0.76	0.74	0.68	0.71	0.74	0.79	0.79	0.77	0.73

Source: author's calculations based on NBR data.

* Formula of calculation: $\overline{VSCCC_i} = \frac{vsccc_i(e) - vsccc_i(m)}{vsccc_i(M) - vsccc_i(m)}$, where

$vsccc_i = \sqrt{\sum_{j=1}^{3} \left(\overline{cccc_i^j} \right)^2}$, where

$\overline{cccc_i^j} = \frac{cccc_i^j}{CCC_i}$

where,

- $vsccc_i$: vector of structure of the current account on credit, at moment (year) "i",

- the "e" between brackets refers to the measured (observed) value of the vector's length,

- the "m" between brackets refers to the minimal possible value of the vector's length,

- the "M" between brackets refers to the maximal possible value of the vector's length,

- $cccc_i^j$: component "j" of the current account on credit, at moment (year) "i",

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- CCC_i: nominal value of the current account on credit, at moment (year) "i"

** Formula of calculation: $\overline{vsccd_i} = \frac{vsccd_i(e) - vsccd_i(m)}{vsccd_i(M) - vsccd_i(m)}$, where

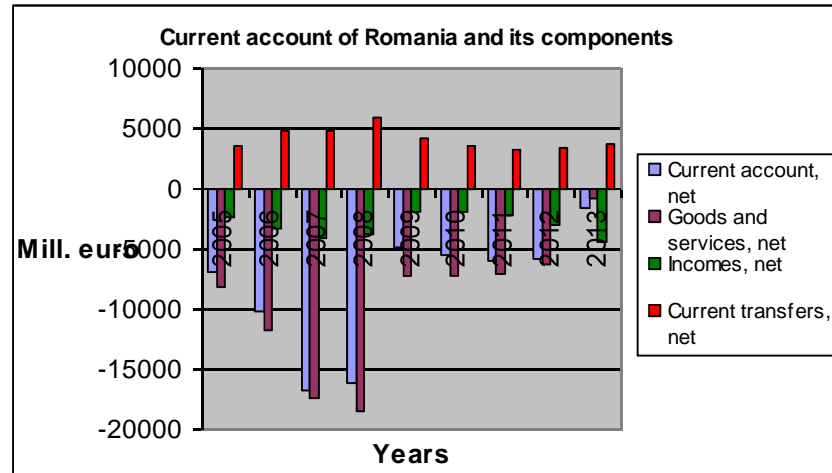$vsccd_i = \sqrt{\sum_{j=1}^{3}\left(\overline{cccd_i^j}\right)^2}$, where

$\overline{cccd_i^j} = \frac{cccd_i^j}{CCD_i}$

where,

- $vsccd_i$: vector of structure of the current account on debit, at moment (year) "i"

  - the "e" between brackets refers to the measured (observed) value of the vector's length,

  - the "m" between brackets refers to the minimal possible value of the vector's length,

  - the "M" between brackets refers to the maximal possible value of the vector's length,

- $cccd_i^j$: component "j" of the current account of debit, at moment (year) "i"

- CCD_i: nominal value of the current account of debit, at moment (year) "i"

The evolution of the balance of the subaccount of incomes oscillated during the analysed period (see Chart 5). Thus, the deficit of the balance of revenues increased until 2007 included, thereafter it decreased and it increased again between 2010 and 2013.

Chart 5

Source: author's calculations based on NBR data

Within the balance of the incomes, the positive balance of the compensation of employees has contributed to the deficit reduction during the analysed period, with increasing values from 2005 to 2007. As of 2008, the positive balance of the revenues from work decreased, with a significant decrease in 2009.

Regarding the direct investment income, one may notice high rates of benefits outflows from 2005 to 2008, followed by a sizeable decrease in 2009. The increase of the deficit of direct investment income has resumed in 2012.

The balance of the portfolio investment income oscillated from one year to the next one, displaying either positive or negative values, which were low.

The balance of income from other capital investment (interests) was negative and it increased from 2005 to 2008, in 2011 and 2012.

In conclusion, the deficit of the subaccount of incomes consists mainly of the deficits of the direct investment income and income from other capital investment (interests).
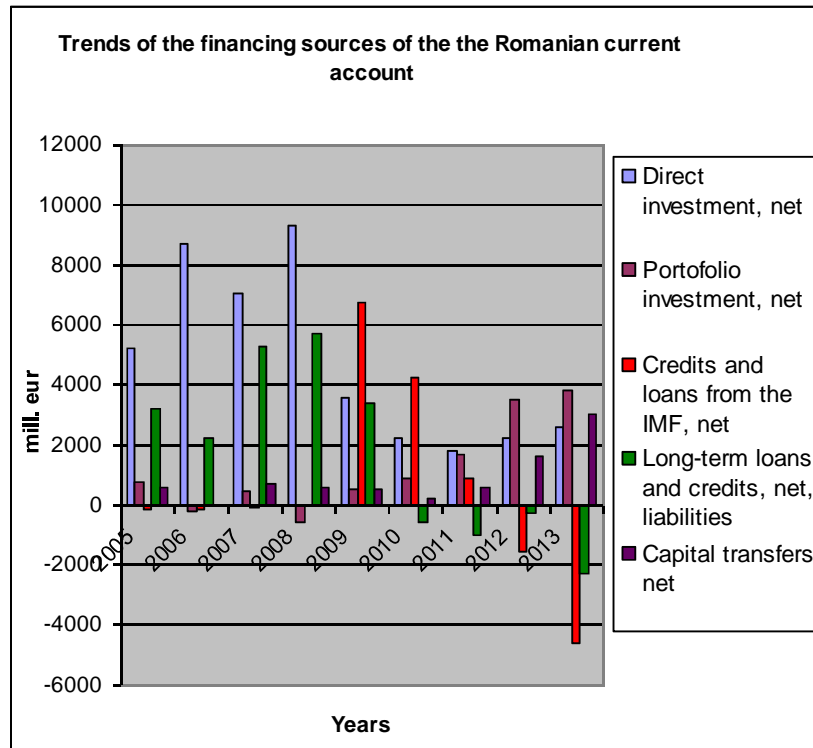
The positive balance of the subaccount of current transfers counterbalanced partially, in each year of the surveyed period, the current account deficit (see Chart 5). 2009 was a year of breach for this subaccount too, when the increase of the positive balance

stopped and it was followed by a decrease until 2001, included. The transfers of other sectors compose most of this subaccount.

3. Financing the current account deficit

The financing of the current account deficit had a turning point in 2009 too; the inflow of "free" capitals decreased, while the inflows of capitals contracted by the state increased (see Chart 6). This was caused by the effects of the economic and financial crisis which had increased the risk aversion of the investors and had decreased the liquidity worldwide, effects transmitted through the channels of trade and trust and by contagion. The situation improved after 2012, when the inflows of foreign direct investments revived slightly.

Chart 6

Source: author's calculations based on NBR data

Chart 6 shows that after 2010, the importance of the capital transfers within the capital and financial account increased on the

background of the higher inflows of capital for the public administration as EU funds. This evolution is rather late because Romania became EU member state in 2007 and it could have capitalised on such funds from the very same year. Implicitly, the transfers of capital contribute in a higher and higher proportion to the financing of the current account deficit.

After 1997, the foreign direct investments have been the main source of financing the current account deficit in Romania. This structure of financing shows a high level of sustainability of the current account deficit in Romania and the state autonomy in relation with the foreign public debt. On the medium and long-term, however, one must take into consideration the limited nature of the privatizable assets, as well as the effects of the world economic crises such as the increase in the risk aversion of the investors, the decrease in the amount of liquidity and the persistence of the basic factors which generated the foreign imbalance. Among them, the most important is the type of economic growth based on the internal absorption, not on the net export, reflected, among others by:

– the existence of a lower rate of growth of exports than the rate of growth of imports (except a few years) (see Chart 1);

– the annual increase, from 2003 to 2008, of the weight of the current account deficit within the GDP (see Chart 4).

The high level of inflows of foreign direct investments in Romania in the years preceding the crisis shows the high confidence of the foreign investors in Romania. While up to 2008, the inflow of foreign investments has not been affected by the international economic and financial crisis, the situation has changed as of 2009. On the background of a higher aversion to risk, between 2009 and 2011 the foreign investors had not considered Romania to be a favourable location for profitable business. This situation changed slightly in 2012 and in 2013 (see Chart 6). It remains to be seen whether this trend is a long-term one or whether it is merely conjunctural. The lower inflow of foreign direct investments in Romania, from 2009 to 2011, is due both to the internal factors, among which the lower stock of privatizable assets, the very poor economic growth which was no longer able to attract green-field investments, and to the external factors such as the higher risk aversion of the investors within the context of the international turbulences, the high crisis of financial liquidities and the lower growth perspectives of the economies receiving foreign direct investments.

In 2009 the current account deficit has been covered mainly by foreign direct investments, on the background of the strong decrease of both the external deficit and of the inflow of foreign direct investments (see Chart 6). The contribution of the foreign direct investments to the financing of the current account deficit has deteriorated as of 2010, as the external deficit increased and as the foreign direct investments continued to diminish; 2013 showed some improvement of the situation as the current account deficit decreased significantly and the inflow of foreign direct investments increased slightly.

Therefore, the net foreign direct investments have been and continue to be a very important factor, which counterbalances the current account deficit in Romania, even though its share has decreased significantly (see Chart 7).
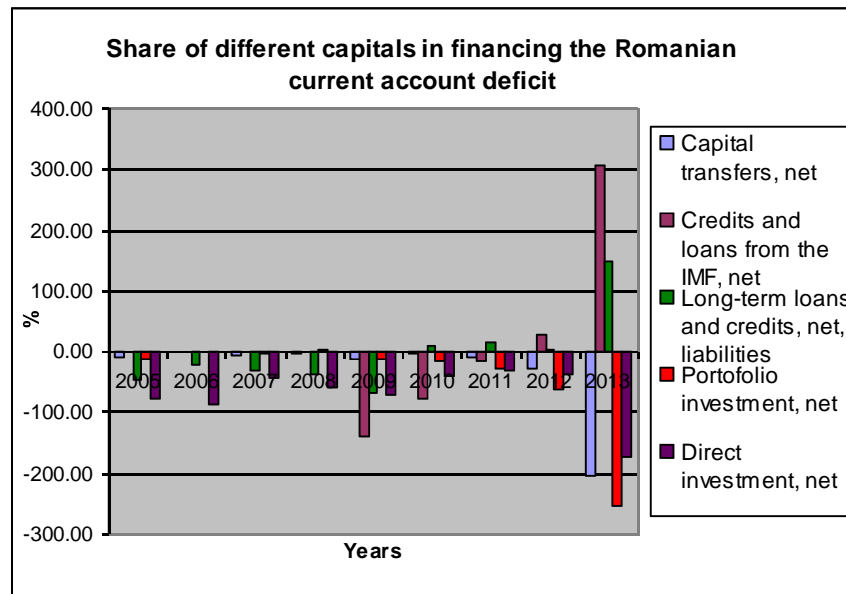
The action of the automatic fiscal stabilizers affected the budget situation in Romania by increasing the amount necessary to finance the public debt. Under the conditions in which the internal resources were insufficient, Romania asked for foreign assistance from the international financial institutions (International Monetary Fund, World Bank, European Commission). Thus, from 2009 to 2011, the credits and loans from the International Monetary Fund were an important source used to cover the external deficit. However, starting with 2012, the situation reversed and Romania started to pay back the loans towards the International Monetary Fund, situation which produced major effects both on the balance of payments and within the economy. Thus, the imports of goods reduced drastically. Therefore, an advantageous structure of the balance of payments has to be found, adapted to the level of development of Romania.

The long-term loans and credits, liabilities, show inflows of funds from private sources from 2005 to 2009, followed by outflows as of 2010. This evolution reflects in the way in which those capitals were used to offset the current account deficit. As of 2011, the situation reversed and these flows contributed to the formation of the external deficit, as some of the loans have been paid back (see Charts 6 and 7).

The use of foreign credits and loans to finance the external deficit and to support the economic growth requires the analysis of the microeconomic risks (higher exposure to a possible foreign shock and the effects on the Romanian banking system) and of the macroeconomic risks as well, in terms of the foreign debt

sustainability. Among the risks generated by the increase of the medium and long-term foreign debt there are the exchange rate risk (an important depreciation of the exchange rate would increase significantly the cost of the foreign financing) and a higher risk premium if the perception of the investors changes and they withdraw the capitals either due to an internal shock or, by contagion, following a crisis in a country in the region, with effects in the direction of the increase of the cost of the public debt service and of imposing harsher conditions on the states which use or are compelled to use this method of financing.

Chart 7

Source: author's calculations based on NBR data
Note: the plus sign shows the contribution to the increase of the current account deficit, while the minus sign shows the contribution to the reduction of the current account deficit

4. Conclusions

From the analysis, we can see that 2009 has represented a breach in the evolution of all the components of the current account, which shows that the economic and financial crisis had multiple

effects on Romania, through the trade and trust channels and through contagion.

All along the analysed period the imports exceeded the exports, which increased the trade balance deficit during the period preceding the manifestation of the international economic and financial crisis. It must be taken into consideration that a high level of dependency of the national production on imports may cause adverse effects on the economy and may affect the sustainable development of the Romanian economy.

The crisis improved the situation because as of 2008, the rate of growth of imports was lower than the rate of growth of exports (goods and services), which improved the trade balance.

Since the imports decreased and the consumption diminished too following the crisis started in 2008, we notice a strong dependency of the domestic consumption on imports. Within this context, we consider proper that the domestic consumers should be oriented towards national products, both by stimulating the Romanian producers to provide the demanded, high quality goods, and by raising the awareness of the Romanian consumers towards national products.

The low share of the exports of goods to GDP shows the modest contribution of the exports to the formation of the GDP, explained by the incapacity of the exports to capitalise the opportunities provided by the increasing openness of the Romanian economy towards the international markets and by the insufficient adaptation of the industrial production to the requirements of the foreign markets.

Since the transportation services are one of the factors, which have contributed lately to the decrease of the current account deficit and given the high demand for transportation through Romania, the road and railroad infrastructure must be developed as fast as possible.

The high share of the current account deficit to GDP shows the negative effect of the current account deficit on the domestic economic process, the conventional sustainability threshold of the current account deficit (5% of the GDP) being constantly exceeded from 2004 to 2008. The share of the current account deficit to GDP has not been a reason to worry as long as the current account deficit was financed particularly through the inflows of foreign direct investments. As of 2009, the share of the current account deficit to

GDP has been lower than 5%, because of the effects of the economic and financial crisis. This evolution shows that an external factor, possibly cyclic, as a crisis, may induce on the short-term a trend of diminishing the current account deficit to GDP, but the change is not for a long period. The decrease of the current account deficit should occur due to the reorganisation of the economy on sustainable bases, so that the share of the current account deficit to GDP doesn't increase when the world economy revives. Furthermore, the economy should target areas of activities in which Romania has competitive and comparative advantages, process which should ensure the medium and long-term sustainability of the current account deficit.

The financing of the current account deficit came mainly from foreign direct investments after 1998 (autonomous sources of investments), which shows the high sustainability of the current account deficit in Romania.

The year 2009 was a turning year for the financing of the current account deficit too, the inflows of "free" capitals decreasing, while the inflows of capitals contracted by the state increasing. This was due to the effects of the economic and financial crisis by increasing the risk aversion of investors and by decreasing the global liquidity, effects transmitted through the financial and trust channels and by contagion.

The analysis of the current account financing in Romania shows the need to find a balanced share between the sources of financing which produce foreign debt and the foreign direct investments, as well as to draw a uniform payback schedule of the due payments, so that the outflows of capital don't affect adversely the domestic economic process.

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