SOME ASPECTS CONCERNING THE FINANCIAL SECURITY OF THE COUNTRY

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Abstract

Given the increasingly globalized economy, in which the inter-dependencies of economic, financial, social, cultural, environmental, as well as other issues are widening, the maintenance and defence of attributes pertaining to sovereignty, independence and national security of each country, become a real and worthy challenge.

In other words, the question arises, how could a country, especially one such as Romania, located at the intersection of particularly important geostrategic interests, manager, to converse national attributes of sovereignty, independence and security, while also fulfilling its obligations deriving from international treaties and bodies at which it is a party.

Keywords: *financial security, GDP evolution, credit institutions, tax agreement, the EU, bank balance, leadership, public debt, budget revenues, privatisation*

JEL Classification: G_{01}, G_{15}

Introduction

In this paper, the focus will be on issues concerning financial security, as important in current conditions as energy security or military power. Remembering only that Greece was (is) a tight rope, without any cartridge being fired in the area. The same goes with Ireland, Spain, maybe Italy, etc.

The main issues addressed concern:

• the economic, social and political environment;
• status of debt of the country;
• excessive privatization of the banking system;
• Romania among the countries of the world;
• management by the foreigners of credit institutions;
• EU fiscal agreement;
• conclusion.

The economic, social and political environment

As it is known, since 1 January 2004 Romania is a member of NATO, as well as through signing the Romanian-U.S. agreement on the location of the missile …starting with 1 January 2007 was admitted as a full member of the …nion. In this context, Romania has brought active contributions to both political-economic and military organizations through participation with troops and military equipment in the various theatres of operations coordinated by NATO, as well as through signing the Romanian-U.S. agreement on the location of the missile shield (*The agreement concluded between Romania and the U.S. on the location of the ballistic missile defence system of the United States in Romania, the Air Base at Deveselu, Olt County, entered into force on December 23, 2011*).

As a member of the European Union, Romania has made and continues to make efforts for the European integration, according to the requirements set out in the Accession Treaty (*Treaty of Accession of Bulgaria and Romania to the European Union, approved by the Parliament on 13 April 2005 with 497 votes for, 93 against and 71 abstentions, signed on 25 April 2005 at Abbey Neumunster – Luxembourg, entered into force on January 1, 2007 after being ratified by the national parliaments of EU member states).*

From apolitical perspective, Romania is a parliamentary republic with a very active "player" president. The political life is dominated by the ruling coalition, consisting of the Liberal Social Union (USL) consisting of Social Democratic Party (PSD), National Liberal Party (PNL) and the Conservative Party (PC), on the one hand, and the Liberal Democratic Party (LDP), the Democratic Union of Hungarians in Romania (UDMR) and the National Union for the Progress of Romania (UNPR), in opposition, on the other hand.

2012 is an election year for Romania, during which local elections (in June 10, 2012) and parliamentary elections (November 2012) will be organized.

Economically, after joining the EU, Romania's economy recorded the next evolution of gross domestic product (GDP):

in % over the previous year

Year	2007	2008	2009	2010	2011	2012
%	+6.4	+7.1	-7.1	-1.2	+2.5	+1.6 (estimated)

Source: data processed by the National Institute for Statistics.

Main contribution of economic sectors to the GDP report at the end of 2010 as follows: industry: 29.7%; trade: 23.8%; financial activities, real estate, renting, business services: 15.7%; education services, health, social work, public order, etc.: 14.1%, construction: 10%; agriculture: 6.7% (Source: EUROSTAT – GDP by Sectors).

The high share in GDP of the industrial sector (29.7%) doesn't suggests, unfortunately, a super-industrialized country (in Germany, the most industrialized country in Europe, the share of industry in GDP is about 20% and in the U.S., even lower), but rather an underdevelopment of other sectors, especially agriculture, which, by scattered farms of subsistence nature, barely feeds 20 million people, although it has the potential (concerning the arable land) to feedover80 million persons.

Overall, Romania's GDP structure highlights the characteristics of a second world country. Since April 2012, the Romanian economy technically entered recession, due to the decreases registered in two consecutive quarters (fourth quarter of 2011 and first quarter of 2012).

Status of the country's debt

Total external debt recorded at the end of 2011, has the following structure compared with 2010:

	billion EUR		% of total	
	2010	2011	2010	2011
Total external debt, of which:	**90,0**	**98,6**	**100.0**	**100.0**
- short term debt	18,0	23,0	20.0	23.3
- medium and long term debt	72,0	75,6	80.0	76.7

Source: NBR.

Government debt, according to EU methodology (government debt), amounted at the end of 2011 to approx. EUR 44.7 billion or 34.3% of the GDP, with the next evolution and structure by maturity:

	2008		2011	
Total government debt according to EU methodology, of which:	billion EUR	% of GBP	billion EUR	% of GBP
	29,8	**13.4**	**44,7**	**34.3**
- short term government debt	5,6	2.5	10,3	7.9
- medium and long-term government debt	24,2	10.9	34,4	26.4

Source: Ministry of Finance.

Structure by components of internal and external government debt is as follows:

	2008		2011	
Government debt according to EU methodology (I+II), of which:	billion EUR	% of total 2008	billion EUR	% of total 2011
	29,8	**100**	**44,7**	**100**
I. internal government debt	12,0	40	22,7	50.8
II external government debt	17,8	60	22	49.2

Source: Ministry of Finance.

As a result, the total external debt of our country, recorded at the end of, 2011 of 98.6 billion EUR, has the following structure by sectors:

	Dec. 2011
Total external debt (a+b), of which:	**98,6 billion EUR**

a) external government debt	22,0 billion EUR
b) private external debt (b_1+b_2)	76,6 billion EUR
Of these ones:	
b_1) banks	24,9 billion EUR
b_2) real sector (production, services)	51,7 billion EUR

Although it is below the maximum stipulated by international treaties (*The Treaty of Maastricht on 7 February 1992 which establishes the principles and foundation for the Economic and Monetary Union – EMU),* total government debt of the Romanian state has grown substantially in the last three years (50% in 2011 compared to 2008), what is really worrying is the fact that the structure component of short-term (up to 12 months) almost doubled in the last three years (up to 84% in 2011 compared to 2008), putting the country in a position to take new loans to repay old ones.

On January 31, 2012 *(Romania returned to the U.S. market after 16 years of absence),* Romania has borrowed $ 1.5 billion from the U.S. market for a term of 10 years at a yield of 6.875% / year with semi-annual interest payment coupons, being the largest amount of dollars on the market recently subscribed for a country in Central and South-Eastern Europe, but also the most expensive.

"If you do not do it based on a strategy, but you do it occasionally, if you don't do it in a credible manner but you do it when the knife is at the bone, the feeling it gives is one of a murderous market, they smell blood and it kills you in terms of cost" (*M. Isarescu – speech at the conference "Romania's choice" European assessment and implications for Romania Bucharest, February 8, 2012. NBR).*

Large loans taken by Romania in recent years and their high cost have made the debt service interest payments on government debt represent approx. 1.8% of the GDP

Excessive privatization of the banking system

After 1989, the state's chase after money and the application, sometimes misjudged, of the requirements of the market economy has led to privatization to foreigners, capital sale of not only entities which the state could no longer sustain, but also some of the most valuable and profitable companies, real "pearls of the crown" (Petrom, BCR, Banca Agricola, Automobile Dacia SIDEX, Tractorul Brasov and so on).

In this context, excessive privatization of state banks lacked real support that Romanian banks could have brought to the implementation of economic and financial policies, as well as to the social reform, through the major revenue they could have brought to the budget in the form of taxes and dividends.

In Romania, the structure of number of corporate and capital banks over the last 20 years has evolved as follows:

	1990	2000	2010*)
TOTAL banking system (a+b), of which	12	41	42

a) Romanian banks of which:	7	33	33
- state owned	5	4	2
- privately owned, of which:	2	29	31
-domestic majority	2	8	5
-foreign majority	-	21	26
b) foreign bank policies	5	8	9

Source: NBR, ARB.

*) The two banks are state-owned, CEC Bank and Eximbank, and the 5 majority domestic private banks are TRANSYLVANIA, Carpathian CREDITCOOP, LIBRA BANK (owned by shareholders directly Romanians who in turn are owned by the NCH BROADHURST – US) and BCR Housing Bank (owned by BCR SA, which in turn is controlled by Erste Bank Group – Austria.

Not only the number of Romanian state-owned banks and domestic private capital was reduced, but also the market share held by them in the entire banking system is low, i.e. 7.4% returns to the two state-owned banks and 7.5% to the five local private banks (which actually is not mostly local) and the remaining 85% of businesses in the Romanian banking market is controlled by foreign banks, which puts Romania in a real difficulty of insuring the financing and crediting of the national economy, especially in times of crisis, when international banks serve primarily the interests of their countries of origin.

At the end of 2011 compared with the previous year, aggregate indicators on credit institutions are shown as follows:

	Dec. 2010	Dec. 2011
Number of credit institutions of which:	42	41
- foreign bank branches	9	8
Total net assets (RON billion)	341,9	354,0
Private capital institution assets (%)	92.6	91.8
Foreign capital institution assets (%)	85.1	83.1
Solvency ratio (%)	15.02	14.50
Leverage (Tier I /Total average assets (%))	8.11	7.90
Overdue and doubtful... (% in total loans)	2.23	2.40
Overdue and doubtful... (% total assets)	1.47	1.60
Return on assets (net profit/assets %)	-0.16	-0.10
Return on equity (net profit/equity %)	-1.73	-1.40
Rate of return based activities (operating income /operating expenses %)	154.2	146.60
Loans to customers/deposits from customers (%)	113.46	116.70
Credit risk (doubtful and loss loans/total loans %)	20.82	23.30
NPL ratio (loans loss and those with legal procedure/ Total		

Loans %)	11.85	14.10

Source: NBR.

Net banking assets totalled at the end of 2011, 354.0 billion RON (81.9 EUR billion), or 63.2% of GDP, reflects the further high growth potential of banking activities in Romania.

The analysis of aggregate indicators on credit institutions highlights the fact that although both in 2010 and in 2011 the rentability rate of the basic activity (calculated as the ratio between the operating income and the operating expenses) recorded very high values of 154.2 % and 146.6%, 2-3 times the cost in the production of goods and services, return on equity (ROE), the return on assets (ROA) have recorded in the two years analyzed negative levels, both as a result of provisioning costs needed to cover bad loans, but also due to transfer of profits to their home countries on account of transfer costs (*Interest costs on financing lines granted by mother banks costs by outsourcing some services and activities of group companies*, *costs of salaries and the bonuses and the other categories of expatriate management etc.).*

This has led, over the whole banking system, to the income provided by the Romanian state budget being quite low compared to the potential as follows:

Tax from commercial banks:	2010	2011	2012
-million RON	276,8	330,2	332,7*)
-mil. EUR at the reference rate of each year	64,6	76,4	77,0

*) According to law no. 293/2011 on the State Budget for 2012, published in the Official Gazette no. 914/22 dec. 2011, Part I

Before privatization, the Romanian Commercial Bank (BCR) contributed only to the state budget with taxes and dividends in an amount greater than the entire commercial banking system today.

Romania among the countries of the world

Globalization of the world economy, manifested primarily on national financial systems, making the “intensity, expansion, velocity and impact of global financial flows and networks to be unprecedented… National financial markets are increasingly rooted in the international financial system, the backbone of economic development of all nations” (Ioan T. Bari, 2010).

Foreign loans, European funds and generally foreign financial assistance proved by their effects on the economic growth to be rather contradictory, because only a small fraction of these flows had contributed effectively to developing countries that have borrowed (the beneficiaries), thus appearing an opposite effect of net capital out flows to developed countries.

Analysis of the Romanian financial market compared to different countries in the world, based on specific indicators is as follows:

a) compared to neighbouring countries:

-in %-

Country	Credits in GBP	Loans, banking deposits	Public debt in GBP
• Romania	21.2	113.3	35.3
• Hungary	21.0	123.6	85.3
• Poland	24.6	106.3	52.4
• Bulgaria	36.0	102.6	16.6

Source: Union Bank of Switzerland (UBS).

b) compared to some developed countries:

-in %-

Country	Credits in GBP	Loans, banking deposits	Public debt in GBP
• Romania	21.2	113.3	35.3
• France	19.4	163.6	84.2
• Great Britain	35.2	150.5	76.7
• Holland	15.7	158.7	66.0

Source: Union Bank of Switzerland (UBS).

c) compared with European countries badly affected by the crisis:

-in %-

Country	Credits in GBP	Loans/banking deposits	Public debt in GBP
• Romania	21.2	113.3	35.3
• Greece	55.7	117.7	130.2
• Italy	25.3	165.2	118.4
• Ireland	56.1	187.3	99.4
• Spain	66.0	223.0	63.3

Source: Union Bank of Switzerland (UBS).

Published analyzes of Union Bank of Switzerland (UBS) based on end-2010datashow that, from the point of view of financial intermediation, as measured by the share of bank credit to GDP, Romania, with 21.2%, occupies a back place, behind it being only Hungary (21.0%), France (19.4%) and the Netherlands (15.7%).

The ratio of loans/bank deposits reveals that Romania (113.3%) has funded loans, especially on account of deposits of the local market, and only 13.3% of loans were funded by resources made available by foreign banks (mother banks), while in other developed countries, the loans were funded at a rate much higher on account of external resources: France – 63.6%, United Kingdom – 50.5%, Netherlands – 587%, Italy – 65.2%, Spain – 123.0%, Ireland – 87.3%, etc.

Management by foreign credit institutions

With the privatization of banks, their management was placed in the hands of foreigners, so far, except for the two state-owned banks (CEC Bank and Eximbank), virtually all credit institutions operating in Romania are run by foreigners. This combines with the broad involvement of the Romanian authorities, who have created some of the most permissive legislative framework for access of foreigners to the management of credit institutions. Thus, art. 25 of the Banking Law no. 58/1998 *(Banking Law no. 58/1998, published in Official Gazette no. 121/23.03.1998, Part I, amended and republished in Official Gazette no. 78/24.01.2005, Part I)* stated: "bank leaders must be resident in Romania, exercise exclusively the position in which he has been invested, and at least one of them being a Romanian citizen. They must be licensed, have worked for at least 5 years in banking and not to have caused, through their activity, bankruptcy of companies. Persons designated in the quality of bank leaders must be approved by the central bank before being on duty".

Although the Romanian legislation was rather permissive compared with countries in the area (*See Polish model, according to which credit institutions management councils must be formed of at least half of Polish citizens)* it was even more relaxed by the new banking law (Emergency Ordinance no. 99/6 dec. 2006 on credit institutions and capital adequacy, published in the Official Gazette no. 1027/27 dec. 2006, Part I, approved by Law no. 227/2007, published in Official Gazette no. 480/18 July 2007, Part I, which was repealed Law no. 58/1998):

(1) The operative business of a credit institution must be provided by at least two people;

(2) The persons referred to in paragraph (1) must have the reputation and experience to exercise the responsibilities assigned, respectively Ordinance no. 99/2006, at art. 13.

Being privatized at the expense of foreign capital, it has imposed point of view, motivated by the fact that share holders are foreigners who have invested capital and have every right to appoint the management of the credit institution.

To demonstrate how unjustified is such a viewpoint, we analyze the balance sheet structure of credit institutions, which looks like this:

BALLANCE

100,0%	ASSETS	100%	LIABILITIES
8,0%	Fixed assets	14,5%	Capital
79,0%	Loans	70,0%	Deposits on local market
11,0%	Minimum reserves	13,3%	External financing
2,0%	Cash	2,2%	Others liabilities

Therefore, the total resources of banks, only ¼ are resources invested by foreign capital (in the form of equity and external financing lines), is stored and collected from the local market availability.

It is hard to believe that, for the proper administration of these deposits on the Romanian market, the foreigners would be more interested than Romanians. The management provided by foreigners is also questionable, because they assume management of the bank on a short term contract (2-4 years usually) by making a number of indicators (targets).

Driven by the lure of huge salary bonuses, foreign managers find solutions fulfilling formal indicators (targets) that the contract have mandated, sacrificing long-term interests of the bank. To illustrate this in terms of some indicators which are necessarily part of the set of 8 to 10 target indicators stipulated in the warrant. These indicators are: return on assets (ROA), return on equity (ROE), profit per employee, etc.

Although these indicators normally should increase by increasing profits, they can grow easily in other ways, such as sale and lease of their own tangible assets, reducing the number of employees, shareholdings in other (non-) banking institutions, outsourcing of activities and services, etc.

Fiscal agreement with the EU

Romania agreed in December 2011 with the EU fiscal agreement, designed as a new fiscal pact and a strengthened coordination of economic policies on the one hand, and development of instruments for stabilizing and responding to short term challenges on the other hand.

The main provisions of the tax agreement are:

- General government budgets shall be balanced or in surplus, the rule being that the annual structural deficit does not exceed 0.5% of the nominal GDP.
- Introduction in national constitutions or in equivalent acts of this provisions accompanied by triggering a mechanism for automatic correction of any deviations from the set level.
- Projected national budgets will be presented first to the European Commission, which will review and will be entitled to request their modification if applicable.
- Maintaining public debt of each member state to 60% of the GDP.
- Member States facing budget deficits above 3% and the public debt of 60% of the national GDP will be required to adopt automatic correction mechanisms.
- Starting with the summer of 2012, the European Stability Mechanism (ESM) will become operational and will take over the current European Financial Stability Facility (EFSF), will have funds in the amount of 500 billion and will discuss and coordinate all economic policies of the euro area countries.

The introduction of these provisions in national legislation of the highest level (constitution) will be verified by the European Court of Justice. Violation of the treaty automatically leads to a fine of 1% of the GDP, which in the case of Romania, taking into account the current level of GDP, would mean approx. EUR 1.3 billion.

Tax agreement was approved by EU leaders on Dec. 9, 2011 in Brussels, being agreed initially by 17 members of the euro area and vehemently rejected by Britain, and other countries such as Poland, Finland, Hungary, and Czech Republic.

After heated debate, the Agreement was signed on 02.03.2012 by the 25 EU countries except Britain and the Czech Republic, who abstained, considering the proposals to be like a "straitjacket."

Although not a member of the euro area, through signing the EU fiscal agreement, Romania gives a great deal of its national attributes of fiscal and budgetary policy, these remaining to be established in Brussels.

Conclusions

As a result of measures taken internally, coupled with the current financial and economic crisis, Romania is rather in a state of financial insecurity, caused by difficulties in obtaining loans, and when it does, the costs being very high, by the lack of appetite of credit institutions to finance the real economy in general and some industries in particular (see agriculture), by stopping financial flows from parent banks to domestic market, the difficulty of attracting European funds and of insuring financial resources for funding.

Approaching term for repayment of the loan from the IMF, World Bank and European Commission (*See Ilie Mihai, Romania's loan agreement with the IMF, WB and Economist no. 2869 (3895)/12 March 2009; Although the loan was hired mainly to ensure the stability of the exchange rate of the national currency against the major currencies (EUR and USD), in fact a great deal of money has been used to cover wage bill and pension payments in the public sector and the exchange rate of the leu depreciated against the EUR constant: 3.9853 RON/EUR for December 31, 2008; 4.2282 RON/ EUR for December 31, 2009, 4.2848 USD/EUR to December 31, 2010 , 4.3197 RON/EUR 31 dec. 2011; 4.3780 RON/EUR to March 20, 2012)* amounting to almost 20 billion EUR to which we add the fact that national economy entered a new recession, and the fact that 2012 is an election year, with consequences of rigor (*Coalition government in March 2012 has already taken policy decision to increase salaries in the public sector by 10-16%, although the approved budget for 2012 is not provided financial resources to cover this increase*), makes the future from the financial perspective, not too bright.

Signing the Fiscal agreement with the EU suites, Romania, perhaps too early, considered that the prospect of the euro area remains distant, in a true "straitjacket" that will affect more attributes of independence, sovereignty and financial security.

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