THE RELATION BETWEEN EXTERNAL DEBT AND ECONOMIC GROWTH ACROSS EUROPEAN UNION MEMBER STATES. DOES ECONOMIC GOVERNANCE MATTERS?

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Abstract

Economic growth and development represent, firstly and without any doubt, main objectives that worldwide countries take into consideration when elaborating their national strategies. What triggers economic growth is a question that still continue to raise the interest of economists, policy makers, national and supra-national institutions or simple citizens. The main purpose of this paper is to analyze the connection between economic growth and external debt, concentrating upon the channels through which this factor influence the evolution of this highly debated process. This analysis is conducted using as a sample of data the 28 member states of the European Union and the data confirm that there is a negative relationship between economic growth and the external debt service.

***Keywords**: Economic growth, external debt, economic governance*

***JEL classification:** O43, O11, F34*

1. Introduction

Economic growth is a desideratum of all economies, as this leads to the rise of income per capita, the rise of the living standards of the population, the general development of national economies and finally to economic progress. A developing country, which is in a process of transition between

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the centralized and the market economy, can build a solid democracy based on a competitive economy and on a modern socio-economic infrastructure system only by using international funding, which generates external debt. Being considered as the foundation of the capitalist economies, the credit instruments are widely used at macroeconomic level. Both the developed and the developing countries turn to internal and external credits because they offer the possibility of spending now and paying later, when the investment starts to generate returns. States turn to external loans when the internal savings are insufficient for financing both national consumption and investments. External credits allow imports to exceed exports, ensuring the financing of the budget deficit and cause the investments to be higher than the savings. Thus, an acceleration of the economic growth takes place, but it is important to remember that that country has to return the loans and the due interests. It is essential for the debiting country to use the external loans in order to develop and modernize the economy and the service infrastructure and not for consumption, because, in this way, it is possible to achieve a sustainable economic growth, including means of stimulating exports, thus, creating the necessary foreign currency resources necessary to honor rhythmically the external public debt. Stimulating exports is one of the most important strategies when promoting external economic relations, because the income from exports represents one of the main sources that can be used in order to return the external debt. This way, the participation of all the states to the world-wide economic circuit is an objective necessity. The complexity of world economy, the high degree of diversity of processes, the rise of the interdependence between national economies, the advantages that can be achieved from international specialization are just some of the factors that have led to the generalization of the international economic trade. Thus, despite their various size or degree of development, states are interested in participating as efficiently as possible to the world-wide economic circuit.

The problem of external debt is now more or less a current one, if we consider the high level that it now has, as well as its effects upon national economies considered individually and also upon the world-wide economy. One important aspect nowadays is attributed to the role that national and supra-national institutions have in managing efficiently the external debt problem and assuring a continuous economic growth. The recent financial crisis triggered an alarm signal upon the need to reconsider the economic governance process in the context of economic growth and external debt. The

European Union structure has some critical particularities when discussing about economic growth and external debts, due to the fact that it has a heterogeneous architecture. There are the west countries with high levels of GDP/capita and the Central and Eastern European countries with lowest values associated to this indicator. At the end of the year 2009, 18 of the European Union member states were in the position of excessive deficit according to the reports published by the European Commission. The new economic governance promoted by the European Union institutions along with the national institutions of the members states aims at monitoring more effectively the budgetary discipline of the countries in order to counteract the effects that a new crisis will generate upon the performances of the countries.

The remainder of the paper is organized as follows: section 2 presents some main contributions in the area of economic growth and external debt, section 3 details the main channels through which the external debt influence economic growth and section 4 summarize the main conclusions and some policy implications.

2. The concept of economic growth and external debt. Literature review

The evolution of the economic growth concept confronted over time with a series of interpretations and definitions that are in the end a strong argument in favour of the dynamics of the global economies. The interdependences between economic growth, economic development or economic progress highlight the increased level of complexity embodied by this process, complexity that may be extrapolated also in the area concerning the instruments of measurement and transmission channels that exist at regional, national or global level

What is economic growth? Although the answer to this question may appear of real simplicity, developing a clear and precise definition may constitute a challenge both from a theoretical point of view as well as from an empirical one. This uncertainty associated to the concept of economic growth corroborated with the attempt to identify the optimum instruments for measurement represents an important objective taken into consideration by worldwide economists. The concept of economic growth is nowadays complementary with a series of terms such as economic welfare, economic development or economic progress with reference to this complex process that embodies macro scale structures. In order to be able to understand the

economic growth process we firstly need to identify the main components of it as well as the interconnections between them.

The concept of economic growth is defined by The New Palgrave Dictionary of Economics as a *”measure of a positive change of GDP within an economy*” (Howitt, David, Weil, 2008, p.231). The production growth is associated in this case with an improvement in what concerns the living standards. In quantifying the GDP component the literature in the field identifies three main approaches: from the production perspective, from the expenditures perspective and from the revenues one (McTaggart, Findaly, Parkin, 2013). If we take into consideration the first one, GDP may be defined as the sum of the net added value within each economy. On the other hand, the second approach defines the GDP as the sum of the overall expenses from the main sectors of one economy. The third perspective states that the GDP equals the sum of all the revenues obtained within an economy, including taxes, wages, profits etc.

We may conclude that the GDP indicator is used as an instrument in analyzing and modeling the data regarding the economic performance of a certain country. The research institutions, national institutions as well as public institutions such as Eurostat, International Monetary Fund or Worldbank, use this indicator as a measure of the performance within different researches or with the purpose of developing certain policies or strategies.

Joseph Schumpeter uses both the concepts of „economic growth” as well as „economic development” (Schumpeter, 1947). In his view economic development is perceived as a spontaneous and discontinues change within the existing steady state that affects the general equilibrium of the previous state. On the other hand, economic growth highlights a gradual change over a longer period of time, due to a general increase of the population as well as of the economy dynamics (Schumpeter, 1947). Schumpeter considers that economic growth is a predictable process that is the result of the favorable evolution of different economic indicators.

According to Simon Kuznets, economic growth embodies in general a quantitative approach. The statement in favour of this is the following one: *„economic growth is essentially a quantitative concept*” *(*Kuznets, 1955, p.16) and calls in favour of a substantial progress in the field of empirical analysis and of”*considering the quantitative aspects as a basis of the economic growth process" (*Kuznets, 1949, p.6). For defining the concept of economic growth within this framework we need to identify both the objective of the economic

activity as well as the final result of it. In defining economic growth, the economic activity needs to take into consideration the contributions in obtaining the general welfare. Despite all that the interconnection between economic activity and economic welfare is hard to be quantified. We consider to be extremely important the analysis of the economic growth process from the quantitative perspective because it highlights in a clearer manner its impact upon the evolution of the economy based upon some empirical results and using a concrete set of data.

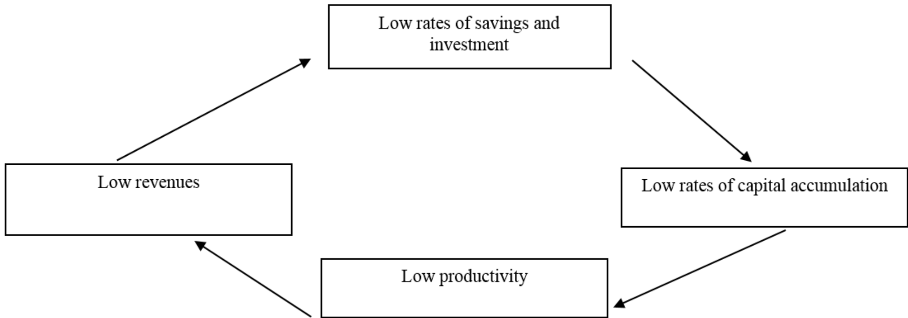
The time variable is considered by Arthur Lewis to be the fundamental element within the economic growth process. The author argues in favour of the fact that not the overall production, but rather the growth rate of this production adjusted with the population growth rate, represents the main pillar of economic growth. It also recognize the important role that the consumption and the resource distribution has upon the economic growth process.

If we were to summarize the main characteristics concerning the evolution of the economic growth process from a historical point a view, the main categories include (Samuelson, Paul, Nordhaus, William 1989, p.861-862):

1. Population and labour force registered positive trends, but in a smaller proportion than the capital stock;
2. Real rates of wages registered strong increased trends;
3. The share of wages ratio to total output increases over a longer period of time;
4. In exchange of reducing the return rate of capital or of interest rate, major fluctuations of profits within different business cycles may be observed.
5. Instead of a constant growth of the capital/output rate due to capital deepening, this has declined since 1900, few changes being registered during 1950s.
6. There is a massive decline of the rational savings rates characteristic to the XX century.

All these tendencies may be regarded as benchmarks of the economic growth process and they are easily used within the economic growth models taking into consideration the important role that the technological progress component has in the economic growth process. The opposite process of economic growth is economic downturn. Over time savings are situated on a downtrend, generating strong effects upon the main economic indicators. Figure 1 explain the interconnection established between these elements.

Figure 1: The vicious cycle of economic downturn



Source: Samuelson Paul, Nordhaus William (1989), Economics, Thirteenth Edition,McGraw-Hill Internationl Edition, Economic Series, p. 890.

This vicious cycle of economic downturn includes a series of obstacles against economic growth, obstacles that the economies need to overcome for achieving the intended goals. It is a well-known fact that low rates of revenues determine low rates of savings that lead to low rates associated to capital accumulation and that prevent productivity growth, which reflects in low revenues. The elements that favour this vicious cycle are interconnected becoming self-sustaining and complementary, leading to underdevelopment. Therefore economic growth requires cumulative effort declined on several levels.

The complex definition of economic growth includes a series of constituent elements. In our opinion, the following elements stand out in importance:

- emphasizing the growth rate of the GDP indicator per each inhabitant of a country, expressed in real terms;
- the growth of the real output per capita in an economy, during the analyzed period of time;
- the complex process of a long-term evolution, which is manifested by boosting the primordial coordinates of the national economy and by restructuring the society structures;
- the complex process of increasing the amount of GDP and national income per capita, based on the combination and efficient use of production factors;

- the process of boosting the main coordinates of the national economy based on the use and combination of inputs to increase gross domestic product (GDP) and national income per capita;
- the upward long-term trend of the gross domestic product and national income per capita.

One of the major problems the world economies have been dealing with for the past 20-30 years, affecting, in one way or another, the majority of the countries, is the growth of the external debt. This reached 2,000 billion dollars in 1998 (four times bigger than that in 1982), over 2,700 billion dollars in 2004, and 56,900 billion dollars in 2009 (according to the data from www.cia.gov/library). Worldwide, debts create a series of problems for the developing countries, generating dramatic consequences in some of the cases, and even engendering major crises of the external debts. When the developing countries pay the interests and the rates of the loans, they often sacrifice the progress in education or health, the economic growth and the raise of the living standards. Financial resources should run from the developed countries to the developing ones, but this circuit has changed since the debts to pay back the loans concluded in the past are greater and greater. It is thus difficult for the developing countries to reduce poverty and, at the same time, line up within a progressive development trend. External loans allow the economy to invest and consume over its internal capacity limit. The capital buildup is financed thus with internal resources and other resources transferred from the countries that register a capital surplus. The external loans can trigger a faster economic growth and enable the financing of a greater volume of investments. They also encourage the call of internal resources, making use of them in a more reserved, cautious, but without any doubt efficient way. If the external loans are used to finance unproductive activities or to counterbalance the excessive capital export, they add no contribution to economic growth. Moreover, they might even put more pressure on the budgetary operations, respectively, on the payments balance. The public external debt is an essential factor in the assessment of the public finance state. It can also be defined as a consequence of the following macroeconomic aspects (Gaftoniuc, 2000, p.403): - limited production power, compared to consumption, the investments and the public expenses; - insufficient internal savings, compared to investments and budgetary deficit; - an increased deficit of the checking accounts balance compared to the net incoming transfer; - excessive capital movement as direct investments or even capital flight. The International

Relations Dictionary defines the external debt as the amount in currency that a country owes to other countries or international organizations (Marin, Puiu, et all, 1993, p.50). This debt is incurred mainly as a consequence of the concluded external loans needed to supply the budgetary deficit and to make investments, or finance the checking accounts deficit. According to this definition, the external debt represents the public external debt contracted and/or secured by the government on medium and long-term. It is considered thus to be part of the public debt, and therefore, the above definition strictly refers to the external debt in its narrow meaning. A more comprehensive definition of the external debt is the one given by the World Bank. According to it, the external debt notion embodies : public loans, i.e. public debtors' liabilities (government, governmental agents, autonomous public institutions), individual debtors' loans secured by the state, individual debtors' loans unsecured by the state, credits provided by the International Monetary Fund, beside the ones distributed with the ordinary drawings, and also extended financing means (counterbalancing financing, extended means of financing, facilities for oil), short-term public and individual debts that are not secured by the state (World Development Report, 1993, p.316).

3. The impact of external debt on economic growth

The literature in the field of the interconnection between external debt and economic growth highlights the fact that the indebtedness of certain economies triggers negative effects and reduce the economic growth rate.

Over time a series of authors concentrated their research in the area of growth and external debts, studies that reveal a series of characteristics of this important interconnection (Sachs, 1990, p.46):

1) Poor countries, through the imports of capital and technology from the developed countries may register more accelerate trends of economic growth within the period when these imports take place;
2) Free international trade represents the sin qua non criteria for achieving the objective regarding economic growth of the developed and developing countries. Developing countries that are more open to international trade and foreign direct investments, register higher levels of development compared to the ones that are more closed;

3) A low level of taxation accompanied to a low level of public consumption (consumption that is not orientated towards investments) has the effect of boosting the economic growth process, mainly through high rates of investments and savings within an economy. A high rate of taxation, associated with a high public government consumption may determine low rates of investment consumption, all these leading to an economic downturn;
4) The intensification of the economic growth process through orientating the governmental expenditures in some key sectors such as health, education and infrastructure, while the expenditures associated with the subsidies granted to the producers and consumers as well as the transfer of the resources to the producers and economic agents are maintained at a low level;
5) High external debt of the developing countries may constitute an obstacle in the process of economic growth contributing to reducing macroeconomic stability through the increase of the budgetary deficit;

The issue of excessive debt concerns both lending and borrowing countries, meaning that the effort to surpass crisis situations must be a conjoined one. If the lender asks for a rapid acquittal of the existing debt, the indebted country will register a decrease of economic efficiency, with severe consequences upon economic growth, fact which will also affect the return of the rates due in the following terms. The pressure for the acquittal of the debt may also lead to social and political instability, which in turn may lead to a decrease in the number of investments, the process of economic growth being again affected. Therefore, the reduction of the foreign debt burden through negotiations may have beneficial effects on the indebted country. This is why we consider it is important that the measures developed by the International Monetary Fund and the World Bank to be continued; these measures concern the reduction of the debt of extremely poor, highly indebted borrowing countries and their realignment on a trajectory of economic growth.

Furthermore we will presents some effects that external debt triggers upon economic growth (Calea, 2008, p.9):

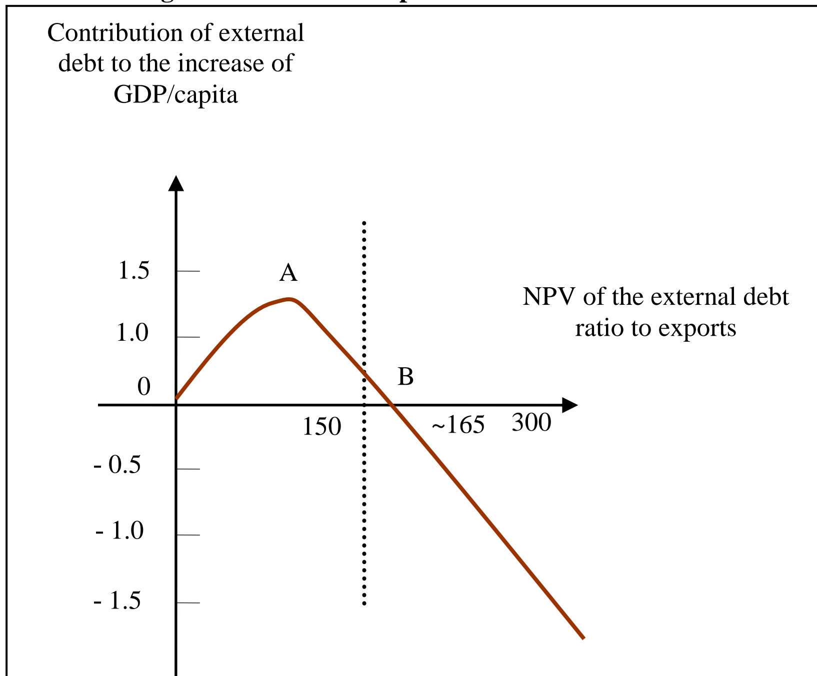
1. **(Debt overhang)**: is the most cited hypothesis that appreciates that the accumulation of the external debt determines the slowdown of the

economic growth process. „Debt overhang" is defined as being the situation in which based on the existing elements it is anticipated that in the near future the external debt will be higher than the refund capacity of the state (Krugman, Benedict Clements, Bhattacharya, Nguyen, 2003). The analyses regarding the theory of debt overhang have as starting point the studies developed by Krugman (1988) and Sach (1989) that analyzed what happens with a state which is able to pay its external debt without a loan. The existence of a consistent stock of the external debts modifies the anticipations both of the debtors as well as of the creditors and the debt decrease may be beneficial for both participants. In fact, there are two versions of this hypothesis. According to the traditional version, the economic agents from the debtor countries as well as the potential foreign investors, perceive a high level of the external debt as a future obstacle that they will have to face (Krugman. Apud. Seiuex, Samy, 2001, p.2). Confronted with a high external debt, the government needs to raise taxes in order to be able to pay the interests for the loan. Increased taxation reduce the results obtained from the capital investment and at the same time is accompanied by the decrease of the interest for investments. Low investments decrease the economic growth trend. Under the circumstances when we assume that the level of the external debts will overcome the capacities of refund in the future, than the governmental authorities will have to take all the measures for avoiding an external debts crisis. The second version of this hypothesis argues the fact that a high level of the external debt service determines a high level of indebtedness that increase the probability that the government will employ an inflationary policy, namely, currency depreciation due to the excessive demand for foreign currencies required for the payment of the external debt service. Even the efforts of the government, orientated towards reducing uncertainty, may generate the decrease of the interest for investments and the deepening of future uncertainties. The empirical studies argues the fact that between external debts ratio (measured as the ratio between external debt and export, or national revenue or GDP) and the economic growth is a reverse correlation. These studies highlight the fact that between the external debt ratio, measured as the ratio between external debt and exports and investment rate to GDP,

namely the increase of the GDP/capita there is a negative correlation, this statement cannot be applied in the case of the relationship between external debt ratio determined by the national revenue and investments and economic growth (Seiuex, Samy, 2001). Alfredo Schclarek tries to highlight the connection between economic growth, both across developed and developing countries (Schclarek, 2004, p.15). The obtained results state the fact that the connection between external debt and economic growth is an important and negative one, a low level of indebtedness is associated to a high rate of economic growth. At the same time the author demonstrate the fact that the reverse connection between the level of indebtedness and the growth rate is determined by the public external debt, the influence of the private external debt being insignificant. Regarding the channels through which external debt influence economic growth, the results argue in favour of the fact that this aspect is due to capital accumulation, concerning the productivity of the production factors, the results being hard to quantify.

Catherine Pattillo et all identified a non-linear correlation between external debt and economic growth as with a shape of a reverse U.

Figure 16: The critical points of the indebtedness



Source: Pattillo, Catherine et all., (2002), `` *External debt and growth*, Finance and Development,``p. 34

The authors state that when developing countries open to the foreign capital inflows and use of the external financial resource, the impact upon the economic growth process is positive. The increase of the indebtedness rate above the level registered in the point A has as effect the decrease of the economic growth level, even if the total external debt continue to have a positive role in the economic growth process. Therefore the level of the external debt market by the point A on the graphic is considered to be the optimum level of the indebtedness that maximize the economic growth. When the level of the external debt reaches the point B on the graphic the contribution of the external debt to the economic growth is negative, the economic framework of the countries deteriorating even more than in the case the country doesn't use external sources of loan. These authors also identified the values associated to these two points considered critical. Therefore it is considered that the impact of external debt on economic growth is negative

when the values of the external debt ratio to exports register a value between 160 and 170%, and the value of the external debt ratio to GDP is situated between 35% and 40%.

2. **Liquidity constrain.** The second element that highlights the relation between the external debt and economic growth is represented by the constrains regarding liquidity, imposed by the service of external debt: a high level of the external debt service may determine a slowdown of the economic growth process by depriving a certain country from the currency resources necessary for the import of capital goods. The concept of international liquidity represents the capacity to cope with financial commitments. There is a clear dichotomy concerning this term: the first one states that within liquidities are included all the foreign reserves of payment that a country needs to cope with some temporary imbalances between expenditures and revenues and the second one according to which international liquidities not only serve to equal the balance of payment but for a multitude of purpose; according to this latter approach in the category of international liquidity are included: reserve assets held by private banks and other holders of international instruments of payment, with the condition that these are legal and liquid or easily to be converted in liquidities. The concept of international liquidity is defined as the ability to finance the payments deficits attributed to the official reserves of gold and currency and by the official access to the international credit facilities (Fleming, apud. Kirițescu, 1978, p.123). In the literature in the field is considered that the link between the external debt service relative to export and economic growth as well as investments is a negative one. The results obtained within empirical studies are mixed. While some authors (Bhattacharya, Clements, 2004, p.49) state that the external debt service influence economic growth by restricting private investments or by transforming the structure of public expenditures, at the same time a high rate of external debt service may limit the available resources for investments in infrastructure and human capital formation with negative consequences on growth. Other studies argue that between the external debt service and economic growth is not a significant connection. Therefore, the hypothesis according to which a high level of external debt service

constitute an obstacle against economic growth by decreasing the imports of goods and capitals needs to be regarded with a certain degree of precaution.

3. **Taxation**. Thirdly, a high level of the external debt service may influence economic growth through taxation, using three different scenarios. Firstly, due to the obligation to pay the external debt service, the government will have to reduce public investments, these having a decisive role upon economic growth. Secondly, by decreasing governmental expenditures, the human capital will be affected, a triggering factor when taking into consideration the economic growth process and a key element within the endogenous growth models. Finally, without a proper budget discipline, an efficient management of the public debt, the governmental authorities may determine a significant budgetary deficit, especially through external loans. The effects of increasing income tax on private investments is less obvious due to the strong dependence within the economy structure: generally privatization, the investments in infrastructure and the financial sector reform are the key elements that may increase the complementarity between the public sector and the private one, promoting economic growth. Understanding the structure of the governmental expenditures is important because the public expenses may be complementary or substituted to private investments. On the other hand, fiscal deficits are influenced by inflation, real interest rate, real exchange rate and the economic results as a consequence of the external debt impact on economy (Arnone, Bandiera, Presbitero, 2005, p.27):
   - Inflation rate tends to increase the budgetary deficit. The negative effect on the budget may be attenuated by decreasing the governmental expenditures if the wages are not indexed;
   - The increase of the real interest rate determines an increase of the payments in the debt accounts and an increase of the budgetary deficit;
   - The consequences of the fluctuations of the real exchange rate act in two directions. A significant depreciation determines an increase of the budget deficit because it stimulates the public consumption, but at the same time, may reduce the budgetary

deficit by increasing revenues due to direct and indirect taxation;

- Economic growth is not a solution for reducing budgetary deficit. Easterly and Schmidt-Hebbe argue that this idea is not a reasonable one due to the fact that generally a sustainable economic growth embodies not only high revenues but also high public expenditures. Moreover, an economy that is characterized by public deficit, a high inflation rate and a high interest rate is unlikely to achieve high levels of economic growth.

4. **Decreasing productivity.** Another channel that highlights the connection between external debt and economic growth is represented by the decreasing of the economic growth productivity factors. The uncertainty generated by high debt directs investments towards the one that have high rates of capital return in a shorter period of time and discourage long term investments that determines the increase of the economic growth productivity factors. Pattillo, Poirson Ricci using the data for the time period between 1969 and 1988 highlights that for a series of highly indebtedness countries, doubling the level of debts will generate the decrease of the productivity factors of economic growth with one percent (Pattillo, Poirson, Ricci, 2004, p.3). Despite all that the magnitude of this effect may be reduced to half under the circumstances of a stable political framework.

5. **Uncertainty regarding future financial flows and debt payments.** At the same time a high level associated to uncertainty and economic instability correlated with debt overhang, diminish the initiatives of applying the modern technologies as well as an inefficient use of the resources. The fifth channel through which a high external debt may influence the economic growth process is represented by the uncertainty regarding financial flows, the payment of the external debt service along with their effects upon macroeconomic stability.

Furthermore we will take into consideration the evolution of the GDP/capita across the member states of the European Union and the evolution of the net external debt as a percent of GDP in order to examine whether the

countries that register high level of economic growth measured by the GDP/capita indicator register at the same time optimum levels of external debt.

Table 1: The evolution of the GDP/capita and net external debts in % GDP in the European Union member states

Country Name	GDP/CAPITA 2013 (current US dollars)	Net external debt in % GDP
Austria	50546,6975	20.2
Belgium	46877,98625	-84.5
Bulgaria	7498,831484	22.1
Croatia	13607,51388	-
Cyprus	25248,98107	115.4
Czech Republic	19844,76165	-5.8
Denmark	59831,69556	9.3
Estonia	18783,05871	-
Finland	49146,64663	-
France	42503,30359	32.4
Germany	46268,64107	-12.2
Greece	21956,41154	130.9
Hungary	13480,91026	58.6
Ireland	50503,4228	-391.4
Italy	35925,87748	59.2
Latvia	15375,44564	35.8
Luxembourg	110697,0291	-2,072.9
Malta	22779,9105	-
Netherlands	50793,14296	41.4
Poland	13647,9647	35.7
Portugal	21733,07306	102.3
Romania	9499,205679	-
Slovak Republic	18046,84318	23.8
Slovenia	23289,33573	34.9

Spain	29863,17672	91.2
Sweden	60430,21558	-65.4
United Kingdom	41787,46798	-
Lithuania	15537,91894	28.4

Source: Authors interpretation using Eurostat and Worldbank data.

From the table above we may conclude that the countries with the highest GDP/capita across European Union structure namely, Luxembourg, Sweden, Germany, Ireland or Belgium register negative net external debt ratio to GDP which means that this countries use sound policies that enables them to maintain an accurate budget discipline. Moreover these countries are developed countries that don't have to rely only on foreign direct investments or foreign capital as a main factor of their economic growth. At the opposite pole countries like Greece, Spain or Portugal face enormous challenges to maintain the external debt service at the optimum level, all the strategies developed by the national authorities not being able to counteract the negative effects that were also amplified by the recent financial crisis. Even if the austerity measures imposed by the government, especially in the case of Greece were drastic, the results were not as expected. In the case of Greece the restructuring of the debt from 2012 affected both domestic and external creditors generating a series of consequences upon the Greek economy and individuals. The increase of the emigration, unemployment and poverty rate, decimation of the health system are only few of the consequences that the external debt crisis generated upon some of the countries from the European Union.

The studies carried out by the International Monetary Fund, the World Bank, the Paris Club, as well as by the most indebted developing states have found that there is an urgent need of new standards for these late category of states, taking into account mainly the fiscal consequences inherent to the external debt. Therefore, in the first place, the indebted states along with international financial bodies shall establish a mutual scenario based on a set of fundamental principles:

- Macroeconomic stability; the governmental expenditures, including the external debt service shall not induce an inflationist fiscal policy;
- The internal taxation ratio shall prompt a sustained economic growth; the internal taxation ratio shall be set so as to contribute to the

promotion of export; the uncertainties for the investors shall be diminished; the employment shall be encouraged and the taxation system shall be maintained stable;

- The external debt shall be reduced in order to reach the above mentioned goals, taking into account the needed timeframe for the adjustment of the budgetary and taxation policies, as well as the magnitude of the budgetary assistance from donor states which is needed by the debtor states.

4. Conclusions and policy implication

It is very important for a country to determine and agree on the optimal level of indebtedness which the economy can handle. This is precisely the reason why the external debt has to be contracted in close agreement with the specific needs of the economy and the loans to be proportional with the economy's ability to refund them. In this way, the risk of a liquidity or solvency crisis can be avoided. Any international financial institution and any lender on the private capital market grants loans to a country only if they have the guarantee that the economy of that country will develop in such a way that it will be able to return the loan. In this sense, a favorable indicator for foreign lenders are the country's reports and negotiations with the International Monetary Fund (IMF). In this case, it is not the size of the loan borrowed from IMF that is of primary importance for foreign lenders, but rather the message of trust that is being communicated to the international community, investors and lenders that an agreement was closed with the aim of enhancing the macro economy and the business climate in that country.

More recently, researchers have been increasingly preoccupied with highlighting the existence of the relationship between the external debt and economic growth, which is what all national economies desire. We also subscribe to the opinion that, during the incipient phases of economic development, it is necessary to have a strong influx of foreign capital which would trigger the economic growth faster. The relationship between the external debt and economic growth is a complex one, differing from developed to developing countries; in the latter's case, the relationship between those two is as important as it is negative. In other words, a low level of external debt is associated with a high rate of economic growth. In this case, it is the public external debt that is taken into account, the private external debt having a minor influence.

5. Acknowledgement

This work was cofinanced from the European Social Fund through Sectoral Operational Programme Human Resources Development 2007-2013, project number POSDRU/159/1.5/S/134197 „Performance and excellence in doctoral and postdoctoral research in Romanian economics science domain”.

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