OVERVIEW OF THE NATIONAL BANK OF ROMANIA'S ROLE IN THE LAST CENTURY[1]

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Abstract

The central bank is one of the main pillars of a country's government and one of the institutions most required to respond to crisis situations in the economy. In this respect, the National Bank of Romania, as the monetary authority of the Romanian state, is constantly subject to such pressure. The article aims to highlight the role that the monetary authority in Romania has had over a century since the Great Union. The research is based on the analysis of some historical documents that testify the major changes through which had passed this institution, as well as the remarks noted lately, especially after Romania's accession to the European structures. The results obtained give a general picture reflecting the role of the National Bank of Romania policy over a century filled with social, political and economic events.

Keywords: monetary unification, monetary reform, currency regime, anti-inflationary policies

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1. Introduction

With the end of the First World War, a new route opens for Great Romania by initiating a series of fundamental changes in the organization and functioning of state institutions. Within this framework, the National Bank of Romania (NBR), as the monetary authority of the Romanian state, is under constant pressure to adapt its role in the different moments of the last hundred years. The objective of this article is to highlight the responsibility assumed by the NBR during the century past from the Great Union. The approach is important to illustrate how the Romanian monetary authority has adapted its instruments and responses to the conjuncture and the challenges it had to respond. For this purpose, we call on exploring both historical documents and recent studies focused on describing the NBR's involvement in national economy.

The economic history since 1918 has been strewn with major events through that have produced various effects on the institutional configuration of monetary authority and on the decision-making and operational framework of its monetary policy. Broadly speaking, the approach takes into account the three periods delimited by the main events that divided the last century: the period between the Great Union and the end of the Second World War; the Communist period; the post-communist period. It is worth mentioning that there have been and other shocks and events that have marked the policy of the National Bank.

2. Literature review

A supporting point is represented by few studies that are essential by the way of capturing in detail the challenges faced by the NBR, as well as by the explanations given over the decisions taken over time. One of the fundamental works on the role of the National Bank from its beginnings until the stage of changes appeared in the first years after the Great Union is that of Victor Slăvescu (1925). This is the basis of many researches in the field of NBR history. In a broader study of the Romanian leu system and its forerunners on the territory of Romania since the pre-capitalist period, Kiriţescu (1997) indirectly performs a critical analysis of the role played by the National Bank in the Romanian economy until 23 August 1944, but also during the communist period and the first years of transition.

In a research on the economic and financial situation of Romania in terms of loans contracted during 110 years (1823-1933), Dobrovici (1934) also addresses the issue of Romanian finances from the first years of the Great Union to the period of the world economic crisis (1929-1933). The 1929 monetary stabilization process is dealt with in detail by Oromulu (1930), Maievschi (1957) presents the effects of the National Bank's decisions on the public finances between 1914 and 1944, and Mariţiu (2006) highlights the aspects related to the implementation of monetary reforms in the Communist period. Axenciuc (2000) has an important contribution in the field of historical research of the economy by building a long-term statistical database that reflects the historical evolution of Romania's economy, including the stage of the Great Union. After 1990 the spectrum of NBR’s monetary policy analysis is expanded with a series of occasional and periodical studies conducted by NBR specialists, while an overview of the period before the global financial crisis is described by Isarescu (2007 and 2009).

Based on the analysis of the referenced works stated above and expanding the horizon with the recent post-global financial crisis, the present paper summarizes the main stages of transformation of the NBR during the one hundred years since the Great Union.

3. National Bank of Romania and its changing role over the century

The end of the First World War brought profound changes for Reunified Romania, which exerted strong pressure on the activity of the NBR as this institution had to cope with new conditions using the old instruments and referring to a legal basis still unchanged. Like the other state institutions, the NBR had to manage, on the one hand, the problems stemming from a disorganized economy as a result of the war, and on the other hand, those specific to the three Romanian provinces.

The NBR continued to be the fundamental institution of the national economy and the Romanian state, attributes of which were evidenced especially by the support granted to these two pillars. Thus, as the state could no longer cover the needs of a "drained treasure" (Slăvescu, 1925), and its fiscal rights could not be exercised on the whole territory, the National Bank was the main source of credit for the state.

From an economic and financial point of view, during the first years after the war (1918-1923), Romania was experiencing a very difficult period marked by a deepening of the budget deficit, and the accumulation of important internal and external public debt. For the recovery of the economic situation, the NBR played a crucial role by increasing the monetary emission in order to cover the budget deficit. At the same time, the inflationary depreciation of the domestic currency has worsened, both in relation to commodities in the domestic market and in relation to other currencies, as a factor that stimulated speculative shares[2].

By the monetary union effected by the NBR between 1920-1921 the foreign currency was gradually removed from circulation and the application of the leu's money system on the entire territory of Romania was generalized, but the existing currency surplus resulted after the war could not be eliminated, so afterwards this event the monetary mass continues to grow while maintaining the depreciation of the leu.

In order to lay the foundations for economic development after the end of the war, it was necessary to achieve monetary stability and, implicitly, to liquidate inflation. Although there was the question of returning to pre-war monetary systems based on gold monometalism, no capitalist country in Europe was able to take this step. Many European countries (Germany, Sweden, Austria, England, Italy, Belgium, Poland, France, Denmark, Norway) pursued monetary reforms to restore the old monetary systems but failed. The monetary problems to be solved were complex as they did not only refer to stopping inflation, liquidating the abundance of coins circulating during the war, but also to creating a balance between the monetary mass and the needs of the economy.

Until the outbreak of the global economic crisis (1929-1933), Romania is experiencing a process of economic recovery having the support of a developing and improving functioning of the financial system. The NBR is involved in the financing of the economy through the National Industrial Credit Society (established in 1923), which granted industrial loans to Romanian companies based on bills of exchange that were subsequently re-discounted by the NBR. In this

[2] *At that time, currency speculations were accentuated both by the introduction of currency in the country through illegal operations and by the high level of the exchange rate set by the government for Austro-Hungarian crowns.*

way, a large part of the discount credits, specific to the emission bank, and which are short-term loans, were actually used for industrial investment. Maievschi (1957) mentioned that over 50% of the NBR's trading portfolio represented outlay in industry, hence long-term investment, which meant that NBR's important assets were immobilized, affecting the bank's liquidity.

During this period, the issue of monetary consolidation through a deflationary process is becoming increasingly acute, which has been implemented since 1925, through the gradual repayment of the state's debt to the NBR and the blocking of these cash, so that the volume of banknotes in circulation meet the needs of the economy. By limiting the emission, the NBR has reduced its capacity to support the economic activity in a period of economic revival, with an increasing demand for loans. This was represented by the rise in prices, with rising interest rates and bank fees being reflected in higher product costs on the internal market, causing domestic depreciation of the national currency by inflation.

The new monetary stabilization process of 1929 was the basis for Romania's economic development, as monetary instruments were considered to be the solution for problem solving. It coincided with the onset of the global economic crisis and meant a devaluation of the leu and a strengthening of foreign capital, as the National Bank had insufficient reserves of gold and currency, and its discount portfolio was immobilized. Moreover, the insufficiency of domestic capital and the poor state of infrastructure, as major impediments to the development of the economy, required the attraction of foreign capital, which was done by the support of foreign banks. Dobrovici (1934) mentions that the major emission banks have agreed to be involved in Romania's monetary stabilization operation and to the formation of a strong banking group (American, English and French) to provide the necessary loan for monetary stabilization. Through the new reform, Romania's monetary system is still based on gold monometalism, but with a devalued currency as a reflection of inflation depreciation in World War I and in the years to come. Kiriţescu (1997) mentions that the application of the 1929 monetary reform meant mainly the granting of external credits to Romania, under very advantageous conditions for the bankers and the business groups that took over these loans.

The World Economic Crisis (1929-1933) disrupts the process of economic development and affects the credit system, which makes it necessary for the NBR to intervene both by granting loans to the state and to important companies in industry and commerce, and by issuing money to cover losses suffered by large banks. But these measures have amplified the inflationary phenomenon. Moreover, efforts to achieve monetary stabilization through external loans have squeezed the NBR's foreign exchange reserves, still affecting confidence in the national currency.

One of the consequences of this crisis was the collapse of the system created by the 1929 monetary reform.

In the period after the global economic crisis, a decisive influence on NBR policy was given by Romania's financial relations with Hitler's Germany, and the main financial instrument underlying these relations was clearing as a mean of economic expansion in Romania before the war, and as a way to obtain from Romania's economy, during the Second World War, the financing for the flow of products necessary for Germany and its army. The extra currency issuance caused by Romanian-German clearing, as well as the increase of state debt contracted especially to cover its defence needs, exerted inflationary pressure between 1935 and 1940. In this context, in about three years the re-discount and the Lombard operations of NBR increased about seven times[3], as a result of measures aimed at strengthening the defence capability of the country.

The period before the start of the Second World War marks the growth of the NBR's role as a central institution for controlling foreign exchange operations, regulating the banking system, refinancing the economy, carrying out operations on the open market and massive lending to the state, thus having an important role in consolidating Romania's sovereignty.

It is noteworthy that throughout the entire period after the Great Union, the National Bank directly contributed to the economic development of Romania, supporting the activity in industry, commerce and agriculture by granting advantageous credits, using resources from the monetary issuance and from the money resources of the economy that were in its accounts. Within this framework, the NBR strengthened the position of the domestic capital, and during the Second World War it helped to limit the implementation of Hitler's projects aimed at systematically exploiting the country's resources. However, as noted by Kiriţescu (1997), the NBR policy was not constantly directed to counteract the domination trend of foreign

[3] *From 3.6 billion lei in 1938 to 25.3 billion lei in 1941.*

capital, given that the 1929 monetary stabilization meant a capital import under unfavourable conditions for Romania.

Simultaneously with the establishment of the communist regime, the NBR policy was profoundly changed by passing it into state property from January 1, 1947, and from 1948 under the new title of Bank of the Romanian People's Republic, is subordinated to the Ministry of Finance.

The persistence and amplification of the inflationary phenomenon, reflected by the excessive growth of money in circulation, from 54 billion lei (in 1939) to almost 49,000 billion lei (in 1947) (Axenciuc, 2000), made it necessary to implement a monetary reform, achieved through a new monetary stabilization, in August 1947. By radical deflationary methods, the new monetary reform meant the sharp reduction in money supply, from 48.451 billion lei on 14 August 1947 to almost 1.38 billion lei in the next day (Kiriţescu, 1997). Thus, post-war inflation was suddenly annihilated, capital accumulations were liquidated, but subsequent analyses made by communist leaders (Mariţiu, 2006) indicate an imbalance between demand and supply with the risk of price instability. Gradually, it was evidenced that the monetary stabilization of 1947 failed to create a stable environment with low inflation, and therefore through the new reform of 1952 attempt to stop inflation.

The fall of the communist regime brings a series of transformations in the role of the NBR in the economy, together with a remodelling of the financial-banking system on a basis that corresponds to the market economy. In March 1991, by Law no. 33 on banking activity and on the NBR Statute (Law no. 34) it was established a new two-tier banking system, where the NBR becomes the central bank of the Romanian state, the only issuing body empowered to establish and conduct monetary, foreign exchange and national credit policies, while ensuring banking regulation and supervision.

In the first ten years, the years of the transition to the market economy, by redefining its status in relation with the internal economic policy and the financial system, the NBR faces major challenges: very high inflation, the deepening of the balance of payments deficit, the exhaustion of foreign exchange reserves.

The increase of the inflationary phenomenon in the first part of transition, with a peak reached in 1993[4], was determined by structural, psychological and monetary factors, reflecting both the functioning of a rigid and anachronistic price system, incapable of transmitting corrective signals regarding the allocation of resources in the economy (due to the lack of correlation between very high domestic demand and limited supply), as well as structural imbalances in the real sector, financial blockade by creating artificial currency and incompatibility between adopted economic policies.

The conditions created by the rather unstable economic and institutional environment and the significant fragility of the financial system, as well as the assignment of quasi-fiscal tasks to the NBR, did not allow the monetary authority to adopt a clear anti-inflationist orientation for monetary policy, the framework for the implementation of monetary operations in this respect being limited. Moreover, the NBR was in a difficult situation to restore the external balance, given that the administrative mechanisms regulating the activity of foreign trade had been abandoned at the beginning of 1990 and the exchange rate was overestimated, artificially maintained by a fixed currency regime, to reduce the inflationary pressure. However, excessive domestic demand was accommodated at the cost of deteriorating the balance of payments and exhausting the official foreign exchange reserves[5].

Adaptation of the NBR policy to the challenges of transition also implied a gradual change in the currency regime. The opening of the foreign exchange market in February 1991[6] was achieved with the adoption of a dual currency regime, based on two exchange rates of the national currency, one official and the other established on the market, which were then (in November 1991) unified under a regime of

[4] *Inflation recorded in that year, calculated as the average annual percentage rate of consumer price, reached 256.1%. An important factor contributing to such an increase in inflation was the declaration of the domestic convertibility of the leu, a measure adopted by the NBR in 1992.*

[5] *The significant increase in imports and the dramatic decline in exports after the liberalization of foreign trade and the abolition of the Council for Mutual Economic Assistance (CMEA) practically exhausted the official currency reserve in the first nine months of 1990. According to the 1992 Annual Report of the NBR in early 1990, Romania's foreign exchange reserve was US $ 1.5 billion.*

[6] *The organization and functioning of the interbank foreign exchange market in Romania are based on Law no. 15 of August 1990.*

controlled flotation. During this period, the NBR has a pro-active conduct on the foreign exchange market intervening to maintain the exchange rate of the leu on a certain trajectory that would ensure a balance between the internal constraint to reduce inflationary pressure and the external one to avoid the crisis of foreign payments (Isărescu, 2009). The stage of the transition is marked by the existence of multiple exchange rates caused by the manifestation of currency market failures and significant exchange rate deviations from the equilibrium level, but the full liberalization of the exchange rate in 1997 regulated the functioning of the foreign exchange market by achieving an equilibrium exchange rate and increasing capital inflows. Until the onset of the global financial crisis, the NBR intervenes in the foreign exchange market to mitigate the real appreciation of the national currency against the euro[7] as a result of massive inflows of foreign capital.

The operational framework for monetary policy is being adjusted, especially after 1991, by pursuing the flexibility and standardization of the monetary policy instrument with the implementation of specific mechanisms:

- a bank refinancing system through credit line, auction credit, and fixed term credit (in 1991);
- a minimum reserve system, for regulating liquidity in the banking system (March 1992);
- State Treasury General Account, opened with NBR, to eliminate the automatic financing of the budget deficit by NBR.

In the first half of the 2000s, the NBR’s policy was adapted to meet the requirements of European Union membership, which also involved a reorientation of monetary policy towards the policy of the European Central Bank. Direct inflation targeting, the new monetary policy strategy adopted by the NBR in August 2005, together with the capital account liberalization, were applied at a time when the domestic and external macroeconomic environment was stable, with low inflation and economic growth. The NBR's concerns over this period focus on price stability, as a statutory objective of the NBR explicitly assumed since 2004, and in support of its approach, it attaches great importance to communication with the market and the public, and emphasizes the

[7] *Since March 2003, it is going from the dollar to the euro, as a reference currency in the foreign exchange market.*

importance of its independence both to the pressure of the political factor and in terms of the use of monetary instruments. The analytical framework for monetary policy is changing so that interest rate policy becomes a priority, as a necessary tool to adapt to the new monetary policy strategy, but also to restore banking intermediation. High inflation expectations, fiscal domination, net debtor position of the banking system, and massive capital inflows were important challenges for the NBR before the global financial crisis (Criste and Lupu, 2015).

Some of the NBR's challenges have disappeared after the global financial crisis (massive foreign capital inflows, domestic currency appreciation, as well as changing the position of the NBR from that of the net borrower to that of the net creditor of the banking system), but this did not mean reducing its burden. Thus, the reduction of external financing under the conditions of the imbalances accumulated before the crisis (the deepening of the current account deficit of the balance of payments) created higher volatility in the money and foreign exchange market, with the risk of affecting the price stability, but also of the private sector indebted to foreign currency. After 2008, the NBR had a prudent behaviour by disrupting the trend of raising the monetary policy rate, thus adapting to the new conditions generated by the global financial crisis. In doing so, it has intensively used minimum reserves as a macro-prudential instrument, provided reserves to banks through the lending facility, has conducted foreign exchange and repo transactions, aiming to create the necessary conditions for the resumption of lending to the private sector and to avoid excessive volatility of exchange rate (Criste and Lupu, 2015).

Gradually, through the measures adopted after 1990 and through its conduct, the NBR has gained its internal and external credibility, thus becoming a fundamental institution for ensuring financial stability. This period of events has permanently imposed the adaptation and building of policies and measures that have helped to overcome the crisis situations and to strengthen the position of the national bank in the economic and financial system of Romania.

4. Research results

The research outlines an overview of the major transformations over the last hundred years suffered by the NBR, and the results are presented in the appended table.

The history of the role of monetary authority in the last century could be divided into three major time intervals, based on major policy changes: the Great Union and the strengthening of the national economy (1918-1939), followed by a period of political crisis in the conditions of the Second World War and the transition to the communist political regime, imposed from the outside; the communist period, where the role of the NBR is subordinated to the policy of the Romanian Communist Party and the post-communist period marked by a series of events that increased the degree of complexity of the NBR policy. During the period under review, it is noted that the inflationary pressure was a quasi-permanent challenge for the NBR.

In the first period, the NBR's policy was broadly focused on the economic recovery and the development support by lending but certain events (Great Depression, Second World War) affected expected outcomes, resulting in higher inflation and less confidence in the Romanian leu. Since 1990, the NBR policy has helped to restore macroeconomic balances and to correct the excessive inflation phenomenon, strengthening its internal and external credibility.

The NBR's monetary instruments have diversified over time, by adapting to a more complex reality and by taking into account the developments of monetary policy of central banks from developed countries: while in the first period the main instruments used were the re-discount system and monetary issuance, in the post-communist period the monetary policy toolbox is expanding, so that it includes the provision of permanent facilities to credit institutions (credit and deposit), the application of the minimum reserve system and a diverse set of open market operations in the money market.

5. Concluding remark

The history filled with events has contributed to refining the NBR’s role, the monetary authority being permanently constrained to meet the challenges and demonstrating its capacity to support the national economy. Although there have been periods in which its responsibility has been subordinated to internal and external forces, it has always found the springs necessary to meet the current challenges.

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APPENDIX

The National Bank of Romania and the Context of the Last Century

The period of the Great Union at the end of the Second World War

The period after the First World War (1918-1922)		The period of the development of the reunited economy (1923-1928)		The period of the global economic crisis (1929-1933)		The post-crisis period	
NBR's policy	**Current conditions**	**NBR's policy**	**Current conditions**	**NBR's policy**	**Current conditions**	**NBR's policy**	**Current conditions**
- the increase in the monetary issuance - monetary unification delayed (1921-1922)	- deepening of the budget deficit - the accumulation of an important domestic and external public debt - inflationary depreciation of the leu	- indirect financing of the national economy	- restoring the economy - development of the financial system (the establishment of the National Industrial Credit Company)	- NBR interventions by granting loans to the state and large firms - monetary issuance to support large banks	- interruption of the process of economic development and impairment of lending activity - amplification of the inflationary phenomenon - impairment of the confidence in the leu (as a result of the reduction of the NBR's foreign exchange reserves)	- credit control policy - additional monetary issue imposed by the relationship with Germany (clearing operations)	- the increasing of the inflationary pressure
		- monetary consolidation through deflation (1925) - reducing of the capacity to support the economic activity (impaired lending)	- rising prices - internal depreciation of the currency by inflation				
		- monetary stabilization through external borrowing (1929)	- devaluation of the leu - strengthening foreign capital				

Communist regime - subordinating the NBR's policy to the Ministry of Finance and Romanian Communist Party's policy

NBR's policy	Current conditions
- sudden annihilation of post-war inflation - liquidation of capital accumulations - increasing the imbalance between supply and demand	- monetary stabilization by the sudden reduction of money supply (1947)
- the shift from the dollar to the ruble as a basis for reporting the leu in foreign relations	- new monetary reform (1952)
- the correlation between the money supply and the needs of the economy, unbalanced by the administrative price mechanism	- periodic operations of re-setting of prices and wages (monetary quasi-reforms)

After 1989 (The fall of the communist regime)

Transition period (1990-1999)		Preparing for European Union membership (2000-2007)		The global financial crisis (2008-2011)		The post-crisis period (after 2012)	
NBR's policy	**Current conditions**	**NBR's policy**	**Current conditions**	**NBR's policy**	**Current conditions**	**NBR's policy**	**Current conditions**
- liberalization of prices - opening the foreign exchange market - improving banking legislation (alignment with European standards)	- high inflation - depreciation of the currency - imbalances of the balance of payments	- strengthening NBR's regulatory and supervisory capacities - adopting the inflation targeting strategy - liberalization of the capital and financial account	- the real appreciation of the national currency - the deepening of balance of payments deficit - massive external capital inputs	- the gradual reduction of the monetary policy rate - reduction of required minimum reserves for liabilities in lei and foreign currency - currency swap and repo transactions (provision of liquidity to banks)	- inflationary pressure - depreciation of the currency - risks of financial instability	- strengthening of the prudential regulation framework	- reducing inflation - depreciation of the currency

Source: Authors' conception