# THE MONETARY AUTHORITHY AND ELECTORAL CYCLE IN ROMANIA, AT A GLANCE[1]

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**Abstract**

One of the characteristics that define the monetary authority governance is the independence from the political sphere, and it is established worldwide since the 1980s, after the Bundesbank success in containing inflation, success that was assigned to its quality of an independent central bank. In this article we try to illustrate the development of the central bank independence against the political field, considering also the inflation development, since the beginning of the transition period, in Romania. The objective formulated in this article is part of a broader one, dealing with the relationship between the electoral cycle and the financial policies. The analysis showed that in Romania the relationship between electoral cycles and the conduct of the National Bank of Romania (NBR) is shown through the intervention of the monetary authority for the purposes of correcting the tendencies of a presumptive procyclical fiscal policy, given not only the limits imposed by the NBR Statute, but the desire to avoid the risk of impairing the credibility of this institution by engaging in politics.

**Keywords:** central bank independence, inflation, National Bank of Romania, elections

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## 1. Introduction

The activity of central banks is continuously subjected to changes, and the management of these institutions, defined by the assumed responsibility, by the power to decide, and also by the democratic accountability, have suffered nuances over time.

The central bank independence is becoming a popular feature of central banking institution, particularly after 1980, given the success that marked the independence of the Bundesbank in containing inflation, in the 1970s. Gradually, it is recognized that the political pressure always gives priority to the short-term objectives, neglecting the costs they can produce in the longer term. At the same time, increases the tendency to link the greater independence of central bank to the lower inflation developments.

More recently, after 2007, many central banks from worldwide have been the main agents in managing the global financial crisis and its effects. By the same token, the measures adopted by these institutions implicitly meant broadening its responsibility beyond the statutory provisions, thus increasing the probability of impairing the central bank’s credibility and independence.

Ciumara and Lupu (2015) emphasize that an important source of volatility of macroeconomic policy is related to the electoral cycle. Starting from this observation, and also from the debate regarding the independence of the central bank policy, in this article we try to illustrate the evolution of central bank independence against the political sphere, taking into account, also, the inflation rate, since the beginning of the transition period, in Romania.

## 2. Expounding the central bank independence

The central bank independence, i.e. the free use of specific tools to achieve its goals, is considered one of the conditions for an effective implementation of the monetary policy.

Starting with MacLaury’s observations regarding the definition of central bank independence (MacLaury, 1977), we can identify elements that depict an isolated image rather than an independent one from the political or the government pressure, or from other interest groups pressure. Thus, independence means the accountability in making decisions for conducting the monetary policy, both in front of the Parliament, and in front of the public and banks. Also, this quality of a modern central bank does not exclude the involvement of this institution in public debates and criticism of the Parliamentarians, the government experts, or others agents (financial analysts, businessmen, community leaders). In this context, the central bank independence does not eliminate any need for collaboration with the government, as a public institution that operates within a framework of responsibilities to the public interest.

There are numerous studies dealing with the topic of central bank independence. Some of them focus on theoretical issues related to the need for this feature in terms of temporal inconsistency between the economic policy objectives, connecting the economic cycles with the political and electoral ones (Barro and Gordon, 1983; Alesina, 1989; Cukierman, 1992).

An argument that supports the importance of the independence of the central bank against the election cycle is that, usually, politicians do not have the quality to be proficient in the monetary policy field (Cerna, 2014). Moreover, the risk of incompetence at the level of the central bank's management is rather low given the existence of a large number of governing bodies within central bank (Bank Board, the monetary policy committee, the specialty divisions/departments, etc.) that provide specialization and qualification by the division of labour. On the other hand, Cerna (2014) states that, even if the staff of the central bank is highly qualified, it cannot be guaranteed "a priori that the officials always act exclusively in achieving the stated objectives of the institution" (Cerna, 2014 pp. 227). Instead, they can pursue their own interests and not the social welfare, and the personal interest could mean applying an expansionary monetary policy during the election period, in order to increase the chances for the government to be re-elected. Avoiding such a situation is achieved by imposing strict rules for the monetary policy implementation, although the experience shows the need for a more flexible framework in this domain.

In the literature, the debate regarding rules versus discretion reflects the automatic link between the application of the monetary rules and the existence of monetary incentives for those responsible for enforcing these rules. This dilemma leads to the need for such a law on the organization and functioning of central bank to persuade the monetary policy decision-makers to follow a rule for ensuring price stability in the longer term, on the one hand, and to take into account the supply and demand developments in the short and medium term, on the other hand (Cerna, 2014).

Another argument for the importance of the central bank independence relates to the possible conflict of interests in the short-term (those pursued by political candidates in elections and which means their preference for implementing an expansionary monetary policy), on the one hand, and the medium-term objective of central bank (i.e. price stability), on the other hand. It is assumed that an independent central bank seeks the stability, on the medium or long-term, and not the short-term monetary performance.

Empirically, the central bank independence is viewed in conjunction with the developments of some macroeconomic indicators, such as inflation, GDP growth, consolidated general government balance (Alesina and Summers, 1993; Cukierman, 1992; De Long and Summers, 1993). Typically, these studies emphasize that central bank independence is a beneficial attribute for low inflation rate and economic growth (Berger, De Haan and Eijffinger, 2000).

There are also studies that address the topic of the institutional independence of central bank. They start from reality, identifying characteristics of some central banks, considered independent, based on the relationship between the central bank and the government in formulating the monetary policy. Such studies have dated since the 1980s (Barro and Gordon, 1983, Alesina, 1989) and continued in the 1990s (Swinburne and Castello-Branco, 1991, Cukierman, 1992). After 1990, the concernment regarding the central bank independence is focused on evaluating this attribute by identifying elements on which specific indices are constructed. De Lis (1996) and Cukierman (1992) address such a topic. Dincer and Eichengreen (2014) update the earlier research on the assessment of the central bank independence. For this purpose, they use two indices (one weighted and the other unweighted, with values between 0 and 1), which are defined on the basis of some criteria chosen in order to highlight four dimensions of this independence: independence from political pressure, independence in formulating the monetary policy decisions, independence in establishing the price stability objective, and independence against the government from limiting its ability to appeal to monetary financing.

As we have already mentioned (Criste, 2015), the literature offers a wide range of definitions of the central bank independence, but summarizing them, it shows three meanings of this concept:

- independence in setting their objectives, in the sense that the government does not influence directly the central bank's authority to set these monetary policy objective(s) (Debelle and Fisher, 1994);

- independence in choosing their instruments, meaning the freedom to set their intermediate target(s) (interest rate, exchange rate or monetary aggregates), and which Grilli, Masciandaro and Tabelini (1991) called „economic independence";

- institutional independence, in the sense that the central bank management is „endowed" to resist to the political pressures made formally or informally by the government (Issing, 1993). Grilli, Masciandaro and Tabelini (1991) emphasize that such a feature depends on: the tenure for the members of the governing body (the Board of Directors); the number of members of the governing body; the degree of the political diversity regarding the nomination process for the central bank's leadership. These three elements are considered directly proportional with the degree of the institutional independence of the central bank.

## 3. An overview on the developments of the independence of the National Bank of Romania, in relation with inflation and electoral cycle

The organization and functioning of the National Bank of Romania has undergone major changes since 1990, changes directed towards increasing both institutional independence (political) and operational independence as preconditions for economic development.

The turmoil years of the transition towards the market economy are reflected by the very amendments to the Statute of National Bank of Romania. The three changes made between January 1991 and June 2004, actually reflect a continuous concern of the public authorities towards improving the conduct of monetary policy, one direction being to increase the degree of central bank independence. Although by passing the Law No.34/1991 the central bank became more dependent of political field, in 1998, the Law No. 101/1998 gave a higher level of the institutional independence for the National Bank of Romania. Preparing for the Romania's accession to the European Union, as well as the changing of the monetary policy strategy from the monetary targeting to the inflation targeting (adopted in 2005), implied an increasing level of the monetary authority independence, given both the conditions imposed by the quality of the NBR's future member of the Eurosystem, and the new monetary strategy to be adopted. These changes are reflected in the new statute of the NBR adopted by the Law No. 312/2004. The questions regarding the conducting of the monetary policy during this period, and how the Romanian monetary authority was adapted to the new challenges faced are explained in more detail in Pop et al. (2007). This work is an important referential to the subject matter hereof.

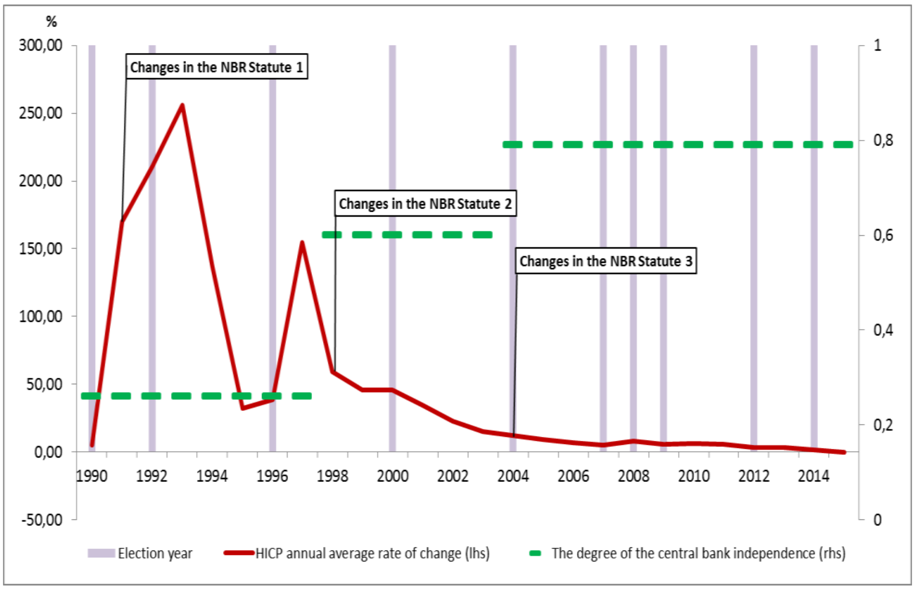
In order to illustrate how the NBR independence and the inflation in Romania have evolved during 1990-2015, pointing also the election years, we use quantifiable data. Thus, the developments of the central bank independence is expressed through the central bank independence index (CBIW)[2] calculated by Dincer and Eichengreen (2014). According to authors' calculations, in 2010, the CBIW was 0.79, a higher level than 1998 (0.60).

The transition from the level of 0.60 to almost 0.80 was realized in 2004 when it was the last improvement of the NBR Statute. Before 2004, there are calculations made by Neyapti (2001), showing a 0.26 level of the index. Although the methodology used is not the same, it is similar Dincer and Eichengreen's (2014) and so the values of these indices can join for temporal comparison. Also, data on inflation are taken from the Eurostat (for the period 1996-2015) and from Annual Reports of NBR (for 1990-1995).

[2] *The authors (Dincer and Eichengreen) calculate two indicators for measuring the central bank independence: a weighted (CBIW) and a non-weighted one (CBIU). In this article, we use the CBIW.*

**Chart 1**

**Electoral Cycle, the level of NBR independence and inflation development, 1990 – 2015**




*Source: National Bank of Romania Annual Reports (1990-1995), Eurostat Data; Dincer and Eichengreen, 2014; Neyapti, 2001*

As it is shown in Chart 1, in times when the NBR had a lower level of independence, the inflation records high values, and vice versa. Theoretically, this observation would confirm the hypothesis that a central bank, which is independent from the political sphere, would achieve better results on inflation target. However, a lower inflation rate can be explained not only by the increasing of the central bank independence, but also by other factors, such as: changing the monetary policy strategy, improving the operational tools, and, generally, the grinding its operational framework, over time.

The lack of influence concerning the election cycle over the management of the monetary policy for NBR is more visible after 2004, when the frequency of the election periods have increased, but, at the same time, the inflation was kept at lower levels (see Chart 1). However, in 2008, there is some influence of the electoral cycle on monetary policy through the higher inflationary pressure exerted by the relaxed fiscal policy measures adopted by the government. But this influence is an indirect one, because the central bank had to intervene *to correct* this trend, and *not to support* the relaxed fiscal policy.

### 5. Some final remarks

The short analysis conducted in this study confirms that the relationship between the electoral cycles and the NBR's conduit is limited to interventions of monetary authority, in order to correct any trends of the procyclical fiscal policy, and is not influenced by any "election" pressure exerted by the government. This latter aspect is highlighted not only by the limits imposed by the NBR's Statute, but also by the aim of avoiding the risk of impairing the credibility of monetary authority, one of the main qualities of modern central banking, which once destroyed is hard to be rebuilt.

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