

# Patching Up the Romanian Economic Miracle

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A few weeks after the president of the Romanian Social-Democratic Party (PSD), Liviu Dragnea, was arrested on corruption charges, and once the media circus that followed subsided, Romania's political scene seems to have recovered its muted immobility. The overall image is perpetual non-eventful standstill: on the one hand, a ruling Social-Democratic Party which is wobbling around but appears too big to fail; on the other, an opposition that seems too splintered to threaten any hope of change, for better or for worse. If there is anything of significance happening in Romania, it is not at the level of high politics, but in the institutional conflicts that mark the political economy of the country; in technical debates rather than the colorful political scandals that we have become used to. The reason is very simple: the Social-Democrats' support among the Romanian electorate has been hardly fueled by any moral or ideological enthusiasm, despite their occasional flirtations with right-wing groups such as the homophobic Coalition For Family. Their main legitimization strategy has been a pragmatic one: the capacity to provide a relatively consistent economic performance, marked by high levels of growth, and mixed with a splatter of redistributive measures such as minimum wage hikes. Since 2016, when PSD was back in power, their fiscal stimulus seems to have brought the expected results, despite the high levels of administrative confusion, which surrounded the government's tax policy. Although begrudgingly at first, business has been grateful, while wage increases fueled the main engine behind the "Romanian economic miracle": increased consumption.

## Bad Tidings

Starting with the second half of the 2018, however, the miracle has started showing signs of wearing off: already by November last year growth prospects seemed increasingly grim, despite the government's buoyant forecasts. The budget deficit has taken off again, while inflation is more and more wiping out the salary increases of the last years. More disquieting than the rising government deficit, however, is a negative balance of payments that speaks very poorly of Romania's productive capacity. Basically, the increased local consumption of recent years seems to be living off imports rather than finance local production. Thus, most of Romania's foreign debt is private, rather than the result of slipshod budgetary practices: and most of it comes from an unbalanced trade profile, marked by high imports rather than soaring foreign investments. This negative trade balance put further pressures on the Romanian currency, fanning inflation and, as a result, depressing real wages, but without enabling Romanian exports to increase in any significant way.

The panicky effects of this wave of bad macro-economic news on the Romanian government have been visible in the statistics wars in which governmental authorities have been engaged in the last months: in a wrangle that seems unsolvable, Romanian authorities are keen on promising a growth of at least 5.5 %, while most international observers do not seem to [hope for more than 3.4 %](#). More importantly, however, the panicky attitude of Romanian authorities emerged in the conflicts surrounding the credit system. The reason is understandable: consumption has been the engine behind recent growth and, although wage hikes pushed sales levels up, it is hard to maintain this pace without a liberal credit policy. As a result, low interest rates for (household) consumption has

become not just an economic objective for the government, but a battle for political survival in view of the next elections. This has increasingly politicized economic institutions, which up until now, have kept up the appearances of neutral instruments of economic management.

## **Crediting the Miracle**

A case in point has been the discussion around ROBOR, the interbank rate at which banks borrow from one another to cover their liquidity needs, and the main reference point when determining interest rates for households and firms. In December 2018, a few days before the winter holidays, the PSD surprised everybody with an emergency decree introducing what the government called a “tax on greed”: bank assets were to be taxed proportionally with the fluctuations of the ROBOR. The reaction of the Romanian banking milieu was that of scandalized incomprehension: ROBOR had indeed been increasing in the previous year, making household and firm financing more difficult as lending rates also spiked. But, as the Romanian National Bank (BNR) put it in its statement, the increase was mainly the result of rising inflation: the ROBOR rate is established independently, outside the purview of the central bank or of the banks themselves. Moreover, as the central bank pointed out, such a tax would run the risk of falling on the shoulders of bank clients rather than the banks themselves: instead of decreasing financing costs for Romanian households, the government would have simply added another burden. The government’s response has been to accuse the BNR, in a thinly veiled manner, of collusion with private banks, implying that the ROBOR rate could have and has been manipulated, leading to higher financing costs for Romanian debtors. A parliamentary inquiry was opened into the Romanian “currency crisis” of 2008 when, according to Social-Democratic MPs, such a manipulation was evident. The inquiry commission did not come to any definite conclusion, and its results are still debated: more than anything, however, the inquiry was a Social-Democratic victory in its publicity war with the Central Bank, throwing a large shadow of doubt over its decisions. Nevertheless, the radical gesture of the December “tax on greed” was greatly moderated: rather than taxing banks according to the fluctuations of the ROBOR, in April 2019 the government simply decided to replace the ROBOR as a reference point for determining interest rates with another index which, for the moment, has managed to reduce financing costs across the board.

It was a compromise, but one which gave the Social-Democrats some essential breathing room for the time being, as interest rates went down: more importantly, however, this was a strong symbolic victory over the over-prudent monetary policies of the Central Bank, one of the few institutions which has the capacity to oppose the government’s plans in a determining fashion. The ROBOR debate and the publicity war with PSD have put Central Bank authorities in a tight corner as they undermined its control over the monetary mass: lower interest rates will further fuel Romanian inflation and, for the moment, the BNR can hardly do anything about it; raising its lending rate is out of the question as it will trigger accusations of anti-Government bias. In turn, leaving inflation levels unchecked can be also read as a political gesture, as an attempt to undermine consumer. It is a double bind that prodded the BNR to a last-ditch measure: trying to convince the large banks to attract more savings by raising [their deposit rates](#).

The wrangle over ROBOR pointed out also to a structural problem of the Social-Democratic developmental plan, one which seems more evident now that economic forecasts have become rather gloomy. Despite its recent growth, Romanian inflation has been in absolute terms rather moderate, never reaching more than 4.5 %. The worries that marked its return have not come from its magnitude but rather from the symptoms that it unveiled. Its resurgence has been mostly induced by a falling exchange rate, caused in its turn by the negative trade balance. Basically, the increased consumption that has fueled recent growth has also marked its demise, as it spurred a strong wave of imports with little exports to balance out the balance of payments.

This stands in stark contrast to countries like Hungary or Poland which apparently pursued a similar growth model, marked by wage hikes and increased consumption, but whose economic profile was very different: both had witnessed high investment levels in the last decades, either through FDI or more recently through European funds. This led to a much more efficient export-oriented economy, with relatively large trade surpluses and positive current account balance, all of which are currently impossible to imagine in today's Romania. Just as hard is to imagine a Social-Democratic government capable of offsetting two decades of absent investments in time to win this year's presidential elections. Lacking any other form of legitimacy outside economic performance, this is the gamble that the PSD has to take, however: if not restructuring the Romanian economy in the next six months, at least patching up things in time to avoid immediate economic discontent. For these reasons, Romania's main political battles this year, or at least its most violent and its most consequential, will unfold in what will apparently be dry technical discussion about interbank rates, just as seemingly neutral actors like the Central Bank will play an essential role in this year's elections.

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