

# **Using moral suasion in monetary policies of emerging economies: the case of Romania**

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## **1. Introduction**

Moral suasion in monetary policies – efforts of central banks to induce desirable behaviors to various categories of economic actors

Two main forms of moral suasion:

- By negotiations;
- Forward guidance (“Open mouth” operations).

During negotiations with commercial banks or other financial institutions a central bank could offer incentives or could threaten. Very often, these negotiations are kept confidential for a long time.

When resorting to forward guidance, a central bank could use several channels (press conferences, speeches or periodically reports on the monetary policy), in order to influence expectations.

## **2. Some particularities of the moral suasion applied by central banks from emerging economies**

The use of some tools, very successful in the case of monetary policies from developed economies, could be ineffective in the case of emerging economies. In

these circumstances, the central banks from these countries have to appeal to other tools, among them being the monetary suasion.

As many central banks announced the adoption of monetary policy strategies based on explicit nominal anchors which imply the forward guidance use. However, the low level of credibility could undermine the possibilities of a central bank to influence the monetary expectations.

In some countries, central banks use moral suasions by negotiations to influence the operations of commercial banks on the foreign exchange market. They could also resort to forward guidance by announcing the exchange rates targets.

The moral suasion is used to influence the lending operations in various directions: the restriction of general volume of credits or the offer of funds for certain sectors of the national economy. Sometimes, the demands of public authorities that commercial banks provide the needed credits to some enterprises cover corruption acts.

### **3. Moral suasion during transition (1990 – 2006)**

During the communist regime, the banking system included only state-owned institutions. Each bank was specialized in certain operations: foreign trade, investments, agriculture, savings etc.

After the communist regime fall, a gradually reform of the banking system was implemented. In 1991, a law regulating the central bank (National Bank of Romania - NBR) responsibilities was adopted. Some private banks with Romanian capital appeared, but they had only a small share in the banking sector.

In the early years, the state-owned banks continued, mainly, their practices from the communist regime years. The banks had to offer loans to the state-owned enterprises in favorable terms. Many of such credits proved to be, in fact, subsidies for different sectors of the Romanian economy.

The substantial corruption from the 1990s had a component that involved the banking system. Later, it was found that many non-performing loans had been given because of political pressures. NBR failed to prevent such situations and it was later accused that it tolerated them or even contributed to them by moral suasion.

In 1997, Romanian authorities had to admit the critical circumstances of some state-owned banks and, two years later, they accepted the liquidation of *Bancorex*, the biggest commercial bank. Another big commercial bank, *Banca Comercială*, was convinced to take over a significant part of the *Bancorex*'s assets and liabilities. In the debates that followed the liquidation of *Bancorex*, a quasi-official explanation was this bank was sacrificed in order to finance the imports of energy products.

During transition, a main concern for NBR was the exchange rates stability. For this purpose it used, along with other tools, the moral suasion by negotiation.

From the second half of transition, the position of NBR in moral suasion by negotiations experienced significant changes as some important state-owned banks were privatized being bought by foreign banks.

In the first years of transition, when in Romania it occurred a severe inflation and the national currency experienced substantial devaluations, NBR's credibility wasn't at high levels. In these circumstances, the forward guidance tool was rather

seldom used. Later, as there were achieved some successes in securing the monetary stability, the central bank's credibility was improved. NBR adopted monetary policy strategies based on explicit nominal anchors in which the forward guidance had to play a major role.

#### **4. Moral suasion after adhesion to European Union (2007 – 2022)**

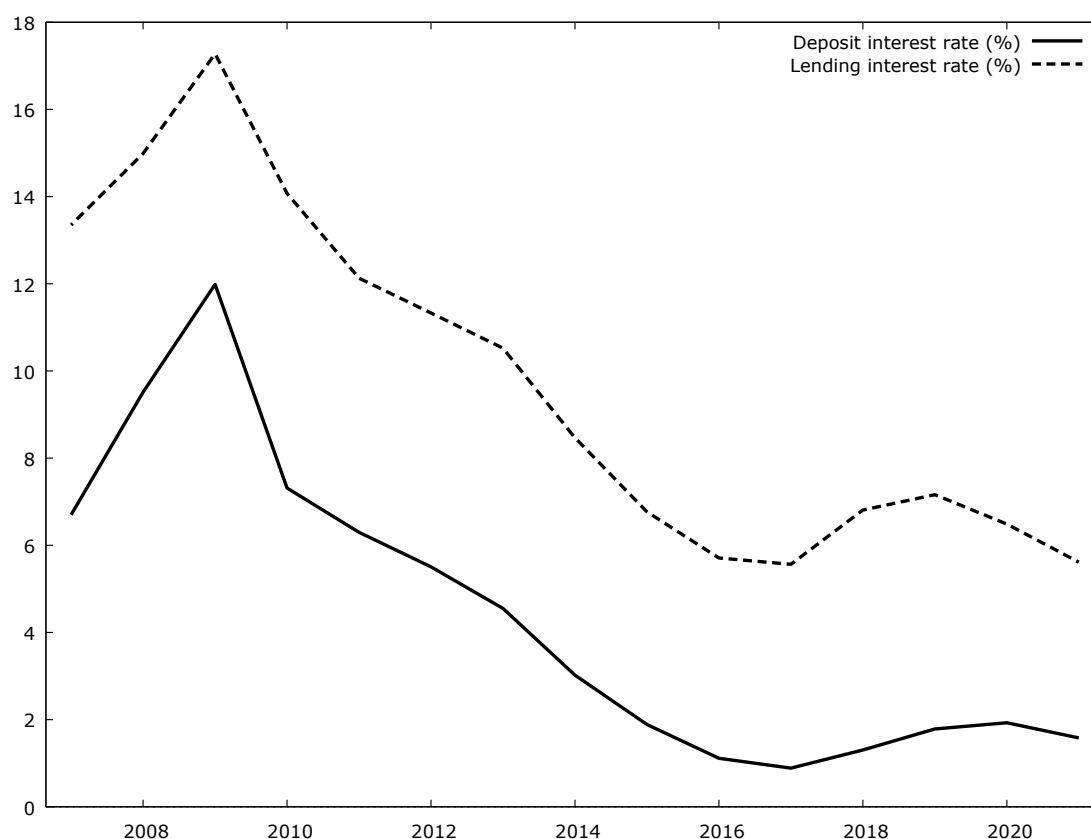
A controversial episode occurred in October 2008. NBR pretended that some commercial banks initiated a speculative attack on the foreign exchange market, trying to devalue the national currency. Some employees from these banks had their own explanations. In their opinion it was, in fact, a moral suasion that was bad organized by NBR.

In the context of European debt crisis, in many emerging economies from Central and Eastern Europe there were fears that western banks that owned domestic banks could withdraw their capital and funds. In order to prevent such situation, the European banks and governments launched the Vienna Initiative that involved negotiations between domestic authorities and foreign banks. In Romania, NBR and the Government convinced the western banks to adopt a supportive position.

The forward guidance was used in the framework of the inflation targeting strategy and also in some exceptional situations.

After the adhesion to European Union the volume of foreign currency loan increased substantially. In 2015, the borrowers experienced difficulties as the national currency depreciated against euro and Swiss franc. NBR had warned about the risks, but it was accused that its statements came too late. Between 2017 and 2019, the borrowers in the national currency were affected by the interest rates raise. In these circumstances, it increased the hostility against banks that

were viewed as “too greedy”. There were criticized especially for the high values of interest rate spread (lending rate minus deposit rate) that allowed them to obtained substantial profits (Fig. 1).



**Figure 1.** Lending rates and deposit rates (annual average values)  
between 2007 and 2021

**Source of data:** World Bank

The representatives of NBR used Media Appearance to explain some particularities of the banking activities. Very often, they were perceived as advocates of the “greedy banks”.

Some events contributed to worsening the perceptions about NBR. In media there were revealed some recent controversial hirings. There were also discovered the

links between the Governor of NBR, Mugur Isărescu, and the former secret police during the communist regimes.

## **5. Conclusions**

On its official site, NBR doesn't mention the moral suasion as a main tool of monetary policy. However, it resorted quite often to the negotiations with commercial banks and to forward guidance.

Because of some controversial aspects, it would be desirable that moral suasion by negotiations to be used only in exceptional situations. Since in the near future there are expected novel challenges for Romanian monetary policy, new negotiations between NBR and the commercial banks couldn't be excluded.

For the monetary policy strategy adopted, the forward guidance could be a useful tool. It would be indicated that NBR's communicators would offer, for the various categories of their public, adequate explanations about the monetary policy and the banking activity. It would be also desirable the improvement of perceptions about NBR in the public opinion.