NOT ONLY ECONOMICS: THE POLITICAL ECONOMY OF EURO ADOPTION IN ROMANIA

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Abstract. *The monetary unification in Europe– the establishment of a single currency for all members of the European Union – has been conceptualized and promoted mainly in economic terms. The economics of monetary unification analyze the (mainly economic) costs and benefits that member states draw from replacing multiple national currencies with a single currency. The political factor has been habitually put aside as the benevolent despot view of the government was tacitly embraced with regard to the creation of the monetary union. Similarly, the process of euro adoption by countries that entered the European Union (EU) later is usually described as being driven by economic factors. The process of nominal and real convergence with older members has been carefully analyzed. Much less weight has been put on the complex interaction of economic and political dimensions during preparations for euro adoption, such as the political interests of national governments and their relation with major internal economic players. The multifaceted interplay of economic and political factors suggests the opportunity to take a political economy perspective on this complex issue. In this sense, a number of key political-economy related issues can be distilled in relation to the process of euro adoption, which will structure the following analysis. What are the key national winners and losers of this possible event? What role has interest-groups pressure played in this process? Under what circumstances may bureaucracies such as the central bank body of experts act as a deterrent for the political end that is the common currency adoption? How are internationally exposed companies expected to behave and to promote their interests in relation to this event? What is the relative importance of the internal politics dynamic for euro adoption? We rely on process tracing to approach these questions for the Romanian case. Policy documents, newspaper articles, academic articles, economic indicators and elite interviews are used to create an analytical narrative based both on a one-point-in-time description of the situation and on a timeline that lists the sequence of some relevant events. We argue that a specific combination of economic and political factors leads to the failed euro adoption in Romania.*

Keywords: *Euro; European Union; political economy; euro adoption; Romania.*

Introduction

The process of monetary unification in the EU – i.e. the establishment of a single currency for all members of the EU – has been conceptualized, discussed and promoted mainly in economic terms. The economics of monetary unification analyze the (mainly economic) costs and benefits that member states draw from agreeing to replace multiple national currencies with a single currency. On practical grounds, a policy-related issue – the necessity to replace the abandoned exchange rate as a policy tool in the hands of national governments – has been usually stressed. The academic and popular debates about the practicability of fiscal policy instruments gained momentum, as did the discussions about the effects that the availability of these economic policy instruments may have on national sovereignty. However, the political factor has been habitually put aside as the benevolent despot view of the government was tacitly embraced with regard to the creation of the Economic and Monetary Union (EMU). Political processes such as treaty negotiations, parliamentary ratifications, and popular referenda have been studied in relative disconnection from the economic arguments put forward in favor of this monetary arrangement.

Theories inspired by the analysis of the Optimal Currency Areas (OCAs) emphasize the best conditions for a country to abandon an autonomous monetary policy (Mundell, 1961; Frankel & Rose, 1998). A floating exchange rate system may successfully be abandoned if the economy has certain mechanisms able to act as built-in adjustment tools, such as internationally flexible and mobile capital and labor markets. In this case, the national economies of a monetary bloc may draw advantages from having a common currency managed by a transnational authority rather than multiple national currencies managed by national monetary authorities.

The rigorous theoretical construction on currency areas is unsuited to explain the monetary unification in the EU (Frieden, 2002). The EU is unlikely to meet all the conditions required for an OCA as labor mobility and correlation among exogenous shocks in various member states are still low. Even the initial, eleven-country eurozone may have not been the ideal area to form a monetary union. Similarly, it can be argued that the present-day drive for the enlargement of the eurozone is far from being an economically motivated process. Therefore, the ongoing political interest for the move towards monetary unification must be explained on different grounds.

One way to extend the narrow economic view on European monetary integration is to look at the factors that influence the behavior of politicians who ultimately decide on a country's monetary institutions. Frieden (1998, p.26) argues that there are three principal factors that made the euro politically attractive, given that a precise calculation of economic costs and the benefit is impossible: the quest for anti-inflationary credibility, the links between the common currency and the European integration, and the support from the powerful business interests. Germany has been a champion of low inflation and monetary soundness and the countries with a weaker monetary record have tried to reinforce perceptions by committing to the rules of the common currency area. Fearing of becoming second-rate countries, the national political elites of the outsiders would face strong incentives to participating in the monetary unification. Similarly, large pan-European corporations would be attracted to the exchange rate stability and would pressure national government to become part of the euro bloc.

Moreover, there are winners and losers of the European monetary integration and identifying these two groups may shade light on the forces at play in this process.

The multifaceted interplay of economic and political factors suggests the opportunity to take a political economy perspective on this complex issue. In this sense, a number of key political-economy related issues can be distilled in relation to the process of euro adoption, which will structure the following analysis. What are the key national winners and losers of this possible event? What role has interest-groups pressure played in this process? Under what circumstances may bureaucracies such as the central bank body of experts act as a deterrent for the political end that is the common currency adoption? How are internationally exposed companies expected to behave and to promote their interests in relation to this event? How did they in fact behave? What is the relative importance of the internal politics dynamic for euro adoption?

We rely on process tracing to approach these questions for the Romanian case. Policy documents, newspaper articles, academic articles, economic indicators and elite interviews with stakeholders in the euro adoption process are used to create an analytical narrative based both on a one-point-in-time description of the situation and on a timeline that lists the sequence of some relevant events. The descriptive power of process tracing is completed by the analysis of some causal inferences that this technique enables (Collier, 2011). Given the fact that the Romanian authorities have not yet made public a calendar for adoption, the relative importance of the aforementioned factors for this failure is analyzed. Since process tracing is particularly suited for gaining insight into causal mechanisms, this methodology is used for the study of the hypothesis that a particular combination of the variables advanced above concurred to the failed adoption of the euro by Romania.

Framework for analysis

Once the limits of the strictly economic perspective have been acknowledged, the process of euro adoption in the new member states of the EU (NMS) has been analyzed by studying the economic and political institutions and other features of the domestic environment in which this enterprise occurs (Dandashly & Verdun, 2015, Dandashly & Verdun, 2016, Johnson, 2006, Johnson, 2008). Tools derived from the political economy and comparative politics traditions have been employed to explain the diverse strategies that these countries enacted.

A first theoretical base for these applied studies is the literature dedicated to the political economy of monetary institutions that analyzes the monetary arrangements that individual countries choose in relation with certain political institutions. Given the time inconsistency and the inflationary bias of monetary policymakers, central bank independence and a predictable exchange rate regime (i.e., fixed exchange rates) evolved to insulate monetary issues from political pressures (Bernhard, Broz & Clark, 2002). At the international level, strategic interactions among governments, compelled by national concerns and constrained by the international environment shape the international monetary system (Broz & Frieden, 2001). However, both the perspective that emphasizes the national preference formation for a certain monetary arrangement and the view that focuses on strategic interactions among national governments in international monetary matters fall short in explaining the dynamics of the EMU. The process of monetary unification in Europe has been an unprecedented endeavor that dramatically transformed economic policy and politics in Europe. Moreover, the sundry strategies of NMS towards euro adoption must be explained taking into account some elements of their internal political dynamic.

Writing at a time when the process of monetary unification was in its early stages, Feldstein (1997) stresses the importance of political motivations behind this move, given his assessment of the EMU as having a negative net economic effect. The desire to promote cooperation and peace while closely guarding national interests, the prospects of an increased cross-border bureaucracy, the willingness of the European political elite to bypass popular preferences related to a common currency have all been extra-economic catalysts for the European monetary unification process. The economic consequences may well be contrary to those expected, as an "artificially contrived" monetary unification is expected to reduce the volume of trade among member states and to increase unemployment (Feldstein, 1992). Friedman's economic and political diagnosis is similar, given that the common market is not integrated well enough in terms of the freedom of circulation of goods and capital (Friedman, 1997).

The real factors of the EU's currency policy (as opposed to the monetary factors) have been found to be significant, as exporters and cross-border investors tend to favor stable exchange rate. On the political economy of EMU, Eichengreen & Frieden (1993) are among the first to study the process of monetary unification in the EU simultaneously from an economic and a political perspective. The authors show that EMU is the outcome of a political enterprise and put forward three sets of political considerations as a point of departure in explaining the dynamics of EMU: interstate bargaining, issue linkage, and domestic distributional factors. The interests that the large economic sectors have in the monetary unification process have also been studied (Frieden, 2002).

The quintessential political nature of the euro is analyzed by Bagus (2010). He points out that the euro shares the same key feature with the rest of today's currencies: it is fiat money. A governmental agency– i.e., the European Central Bank – is entrusted with the power and responsibility to issue the euro for the benefit of the European state. From this perspective, replacing multiple national fiat currencies with one European fiat currency bears no important economic advantages. In fact, the opposite case seems to be unfolding, leading to the author's conclusion that the EMU is a self-destroying, conflict aggregating system since there is no externally enforced mechanism to restrict the money production and the cross-border wealth transfers that it requires.

This article seeks to add to this body of literature by studying the Romanian case of euro zone accession. We classify the factors for euro adoption into three categories. The economic factors include those criteria derived from the OCA theory, such as the economic structure and trade relation, labor market flexibility and the business cycle synchronization. The political economy factors deal with the actions of national and supranational bodies, such as the convergence criteria negotiated during the Maastricht process, the later addition of real convergence criteria, the exchange rate regime, interest group pressure, and the symbolic factor. The third group has to do with internal politics factors, such as the president, political parties and the central bank. The following section focuses on the analysis of some of these factors, while the third section concludes.

Money, politics and policies. The political economy of euro adoption in Romania

Interest group pressures: an apparent lack of interest

What role have interest group pressures played in the ongoing process of euro adoption in Romania? What groups can be identified that pushed for a rapid switch to the euro? First observation on this matter is that in general monetary policy is an area relatively isolated from interest group pressures. The lobbying groups have no means to exclude others from enjoying the benefits nor can they find an effective way to share the costs. Therefore, incentives to engage in this type of lobbying activity are weak (Broz & Frieden, 2001), at least compared to those situations in which the lobbying groups are able to exclude others from benefiting from the special treatment, such as the case of the trade policy. However, the lobbying activity of some groups has been identified and studied in relation with euro adoption in NMS. Haughton (2010) and Dandashly & Verdun (2015) study the Slovak case where the foreign business lobby, especially the automotive industry pushed hard in favor of euro adoption.

Like Slovakia, Romania too benefitted from an increased inflow of FDI, with the automotive industry being one of the main beneficiaries. As one of the key growth drivers for the economy, the local auto industry accounted for 47% of the country's exports in 2016, with Dacia (part of the Renault group), Ford and Volkswagen being the main car manufacturers (Romania Insider, 2017). However, the lobbying activity of this foreign-dominated industry appears to be quasi-absent (interview with BNR official, June 2018).

Money as a symbolic factor: a case of monetary realism

Identities, ideas and the symbolic value that people attach to their national currency are important factors that influence popular attitudes towards euro adoption. The different degree of attachment that people have towards national currency has been studied as an explanatory variable for the diverse speeds and strategies of euro adoption in the NMS (Dandashly & Verdun, 2015).

How much does the symbolic factor explain the Romanian strategy of euro adoption? First, trying to assess the degree of symbolic value that Romanians attach to the leu, one should look at the polls that address this specific problem in relation to euro adoption. The Flash Barometer results for 2018 reveal that in Romania a slight majority of the population (47% vs. 44%) disagree that adopting the euro will mean that their country will lose a part of its identity. The trend, however, is descendant, (with fewer Romanian disagreeing with the idea of a lost identity due to euro adoption) after reaching a maximum in May 2010 – 66% (EC, 2018b). Second, the quality of the national currency may be taken as a proxy for the degree of attachment felt by the people. Romania has seen one of the highest inflation among the countries in the region in the first decade of transition. Inflation rate reached 295.5% in 1993, fell in 1995 to 27.8%, only to increase in 1997 to 151.4%, staying at high levels until the late 2000s. As a result, the degree of currency substitution has been among the highest in the region.

In sum, the Romanian public does not see many advantages in using the national currency and turns to the common currency to save and to make current transactions, a fact confirmed by the high percentage of the public that has used the euro within their country (around eight out of ten of the group of respondents who have already used euro banknotes or coins have done so in Romania or both in Romania and abroad) (EC, 2018b).

To conclude, it is safe to assume that the majority of the Romanian public tends to think of their national currency mainly in economic terms and does not attribute a great symbolic value to the *leu*. Therefore, the symbolic factor has not been an impediment for euro adoption in Romania.

We shall now analyze the internal politics dimension of euro adoption in Romania following the structure of factors of influence used by Dandashly & Verdun (2016) to examine the cases of the Czech Republic, Hungary, and Poland. The first set of factors includes electoral cycles and the role of the elites such as the presidency and political leadership along with the constitutional and legal constraints that they face, seeking to assess the degree of influence that these factors have on the euro adoption process. The second set of factors has to do with the central bank independence to assess how the preferences of the central bank elite impact the process. The last set deals with public opinion as we try to evaluate how the electorate may have influenced the monetary choice of the government.

Electoral cycles and the role of the elites: the declarative political support for the euro

On the one hand, the declarative support for an early euro adoption has been abundant among key political figures. Initially, the Romanian government had planned to adopt the euro in 2014, Prime Minister Emil Boc being so optimistic as to declare that even this date should be brought forward, stating that the government was working at a strategy for early adoption (Mediafax, 2009). However, this plan never came to fruition, 2014, 2015 and 2019 have all been abandoned as target dates. The first Convergence Program issued by the government in January 2007 contained a commitment to enter the Exchange Rate Mechanism II (ERM II) in 2012, while through the 2014 – 2017 Convergence Program the authorities committed to adopting the euro in January 2019. The rest of the programs contained no clear date for adoption, the government declaring in general terms its intentions to adopt the euro at some point in the future. The abandonment of the target was usually disclosed by public statement through the voice of the prime minister (or the finance minister), who emphasized the still unsatisfactory "readiness of the economy" as a key factor for the missed target (e.g., Gheorghe, 2017).

However, on the other hand, a clear timetable for euro adoption has never been made public. Coupled with the reserved attitude of the BNR with regard to an early euro adoption, this speaks to the duplicitous stance of the political elite towards euro adoption. Offering a rationale for euro adoption, the Romanian political discourse began to included elements specific to EU politics, such as the importance for Romania "to join the (eurozone) club" or to "have a seat at the decision table" (Șimandan, Leuștean & Dobrescu, 2017).

In March 2018, the ruling PSD voted at an extraordinary congress to back a 2024 target date for joining the Eurozone (Marinas, 2018). As a result of this decision, a national commission in charge of drafting the timetable for adoption was set up and began its activity. However, this pledge has little credibility given that Romania's economic conditions deteriorated in 2018 to the point that only one (i.e., the public debt) of the four nominal convergence criteria are likely to be met (EC, 2018a). Moreover, the recent expansionary fiscal policy implemented by the PSD government is incompatible with such an ambitious timetable for euro adoption.

As for the role of the presidency, according to the Romanian constitution, any law must be promulgated by the president, who is able to send bills back to the parliament for reexamination or to challenge them to the constitutional court. However, the president may do so only ones since promulgating a reexamined bill is compulsory. Therefore, the president has no veto power in the Romanian constitutional architecture. In addition, the president has no specific economic role.

Since 2004, both president Traian Băsescu and president Klaus Iohannis publicly expressed their support for the adoption of the common currency. President Băsescu has been an enthusiast supporter both of the EU integration and of the eurozone adherence throughout his presidency. “I believe it should be firmly stated in our documents a target date, and an optimum time can’t be other than 2017”, he stated in an interview in 2013 (Caleaeuropeana, 2013). President Klaus Iohannis took every opportunity to affirm the country’s devotion to European values. In his view, joining the eurozone should become a “country project”, a condition for reaching this end, however, being a broad political consensus (Chiriac, 2015).

To summarize, we advance the idea that the political support for euro adoption has been a common feature of all the post-accession governments. However, the lack of concrete steps towards euro adoption coupled with the absence of a commitment to the calendar for adoption leads us to believe that the political support has been mainly declarative.

The role of the central bank: a cautious stance

Across time, the BNR has had a cautious approach towards euro adoption. Officials from the central bank have routinely emphasized the role of real-economy and political factors in addition to monetary factors for a successful euro adoption. Governor Isărescu has long championed putting the process of euro adoption in the framework of the real convergence set of arguments (Isărescu 2007, 2008, 2013, 2015). Unlike nominal convergence, which enjoys a clear-cut legal definition, real convergence lacks definitional precision. Among the criteria used to assess real convergence, per capita GDP has been analyzed in many documents originating from the BNR. The crucial contribution of the fiscal policy to meeting the criteria for euro adoption has been habitually emphasized (e.g., Isărescu 2008).

In the aftermath of the sovereign debt crisis, Isărescu (2013) argues that putting off euro adoption, at least temporarily, seems justified. Trying to rationalize this wait-and-see attitude of the BNR, he offers the following arguments: the common currency has gradually lost its appeal; the advantages of the euro have become less noticeable, while the disadvantages more clear; the reduction in financing costs (as a result of decreased interest rates brought about by the common currency) can no longer be considered a clear-cut benefit; the sluggish economic growth in the euro area makes the further commercial integration less appealing (pp.11-15).

In sum, we hypothesize that the cautious stance of the BNR – grounded in the slow advance of the real convergence – is a key variable to explain the sluggish move towards the common currency in Romania.

The public opinion: an unfulfilled enthusiasm

The public opinion factor may be taken as a proxy for the voice of the electorate that may influence the entire political process (Dandashly & Verdun, 2016, p.6). Romanians have constantly been among the most enthusiastic supporters of the common currency. Eurobarometer data for 2018 show that 69% of the Romanian population is in favor of euro adoption (the highest share, as in the previous report), compared with 27% which is against. The favorable opinion to euro adoption peaked in 2014, with 74% of respondents backing up euro adoption (with only 24% being against). The effect of the financial crisis on the positive perceptions of the euro has been modest: 62% of the population was favorable to the euro in 2008, declining only to 59%, 55% and 51% in 2009, 2010 and 2011 respectively, gradually increasing afterward.

There are several factors that can help explain the constant support for the common currency, notwithstanding the euro crisis. Firstly, given the constant high rate of inflation during the 1990’s and the 2000’s (in 1993) which resulted in a soaring degree of currency substitution, Romanians are not particularly attached to the national currency. Secondly, unlike other countries outside of the euro zone, Romania did not see the protective qualities of a flexible exchange rate regime. Although the real exchange rate of the leu depreciated by 19% between 2007 and 2009, the real GDP dropped by 7.1% in 2009. Romanians could learn that having an internally-managed currency is not an effective shield against outside economic shocks.

For these reasons, we theorize that the public opinion favorable to euro adoption has not been translated into an effective pressure on politicians to speed up the euro area accession. The freedom to use the euro for price quotations, savings, and borrowing, coupled with the fact that euro adoption has not been a salient issue, acted as a substitute for the necessity to officially adopt the common currency.

Table 1. Summary of economic and political factors for euro adoption in Romania (authors’ own compilation)

Factor	Specifics
Economic factors	
Economic structure and trade relation	Improvement of the current and capital accounts; high degree of integration with the euro area through trade and investment
Economic cycle synchronization	Rapidly increasing since 2008
Political economy factors	
Nominal convergence	Maastricht criteria met only in 2015, 2016 and 2017; unlikely to be met in 2018
Real convergence	A slow advancing real convergence
Exchange rate regime	Managed float; a relatively stable real exchange rate
Interest-group pressure	Weak pressure for adoption
The symbolic factor	Not a deterrent for euro adoption
Internal politics factors	

Factor	Specifics
Presidency	Highly supportive; lack of economic responsibilities; no veto power
Priority of consecutive governments	Euro has been presented as a priority; lack of concrete steps towards euro adoption
Elites' support for euro adoption	Highly supportive
Central bank independence	Goal, instrument and financial independence; members of the board politically appointed
Government vs. central bank	Political cooperation until 2016; more conflict since 2016; BNR has had a cautious approach to euro adoption
Public opinion	Highly supportive; slightly declining with the euro crisis

Conclusions

A strictly economic perspective on the adoption of the common currency in the NMS falls short in explaining the widely diverse strategies that these countries embraced. A political economy standpoint, with its emphasis on the features of the internal institutional players and the expected behavior of national and supranational political actors, is in a better position to offer a more realistic view on this ultimately monetary phenomenon.

We have analyzed a number of economic and political factors that could help explain the sluggish advancement towards euro adoption in Romania. Even with the economic factors improving – the economic structure, trade relations, labor market flexibility, and business cycle synchronization have all moved towards greater compatibility with the euro area core – the political economy factors have not been particularly favorable to an early euro adoption. In addition, in spite of a euro-enthusiast internal public, the factors that relate to the domestic political life have not been able to push effectively for euro adoption.

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