CENTRAL BANKING AND FINANCIALIZATION

A Romanian Account of how Eastern Europe became Subprime

Daniela Gabor

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1
Introduction

February 2009 was an unusual month for Central and Eastern Europe. (CEE). First, the international press started referring to it as the subprime region (Ahamed 2009). The association to the infamous subprime mortgage market in the USA described the same process with different actors. In the USA, NINJA (no income no job no assets) borrowers and imprudent banks together created an explosive cocktail that nearly destroyed international financial markets. The CEE countries similarly borrowed beyond their means to finance a fast process of convergence with their neighbouring European countries, mostly through Western European banks present in their banking systems. Austrian banks, for instance, had outstanding loans to the region amounting to 70 percent of Austria's gross domestic produce (GDP). As the collapse of Lehman Brothers in September 2008 saw European bank losses spiral, nothing seemed far-fetched, not even the possibility that these would abandon the region. In the event, global finance faced, according to *The Economist* (2009), a shock at least comparable to the US subprime mortgage market debacle. Second, the central banks of the Czech Republic, Romania, Poland, and Bulgaria accused the foreign-owned banks of speculating in currency markets and amplifying the negative effects of the international financial crisis. While concerns about speculative activity had been expressed on an individual basis during October 2008 (most vocally by the Central Bank of Romania), the coordinated public statement was unprecedented. Poland went further, calling developed countries to carefully assess the bailout strategies for Western banks operating in Eastern Europe. These, the governor of the Polish central bank charged, were using the bailout liquidity to speculate in CEE currency markets rather than to restart lending in home countries (Kaminska 2009).

Yet, by the end of 2009, the doom-and-gloom atmosphere seemed a bad dream. In a spectacular reversal, the CEE became the strongest performing region in the world.

This book sets out to explore how these events are connected. It focuses on central banks as key actors of the account; it treats central banking as a deeply political process; and it approaches it from the standpoint of neoliberalism and financialization.

Financialization and neoliberalism in Central and Eastern Europe

Financialization is a relatively new concept used to explain the quantitative and qualitative shifts in financial systems associated with financial liberalization and international deregulation. Krippner's (2005) popular definition focuses on the increasing importance of financial activities, rather than commodity production or trade, in generating profits. Crotty (2003) further describes a qualitative shift toward "impatient" finance that increasingly replaces the traditional long-term financing of productive activities with short-term market activities. Financialization is juxtaposed with neoliberalism in response to recent pleas for expanding analytical attention beyond the traditional treatment of neoliberalism as free-market ideology (Krippner 2007) or as a static project driven by a singular anti-state logic (Hay 2004). Neoliberalism is approached as ideology and practice, with shifting underlying rationalities: from the destructive attack on the state to a normalized mode where economic and financial relations are redefined through processes of financialization (Peck and Tickell 2002).

An increasingly large and multidisciplinary literature argues that neoliberalism in its financialized stage permeates and reconstructs policy spaces and economic and social relations (Goldstein 2009). Central and Eastern Europe offers an interesting terrain to explore this process, unique because of its historical engagement with neoliberalism after the collapse of socialism. Its transformation from a planned system has been scripted (with different degrees of success, depending on national configurations) by neoliberal insistence on market optimality, deregulation, and (financial) liberalization. By 2008, the International Monetary Fund (IMF) commended the region for successfully harnessing financialized globalization to growth priorities (Fabrizio 2008). In other words, it is no historical accident that the CEE, and not East Asia or Latin America, became "subprime" during the 2007–2009 crisis of finance-led growth regimes and that a large number of countries had to turn to the IMF for emergency support (Hungary, Latvia, Romania, Ukraine, Serbia, and Poland).

Formerly planned economies offer an ideal example of how central banks participated and were in turn structured by financialization. As will be shown, neoliberal approaches to macroeconomic management, built on monetarist economic theories, assigned the central bank a key role in redefining economic relations after the collapse of socialism. Since the superiority of neoliberalism was predicated on the superiority of the market, policy advice prescribed the depoliticization of economic decisions and the institutionalization of "a technical set of devices" for managing increasingly interdependent economies (Hay 2004). This naturalized the central bank as the institution par excellence fit to design, and ensure the deployment of, such devices.

Why Romania, and to what extent is it representative of regional dynamics? The focus on the specific dynamics of the Romanian policy space arises from conceptual and personal considerations. Following Karl Niebyl (1946), the political economy of central banking must pay equal attention to policy argumentation and institutional configurations. Data is important but requires interpretation, and there is seldom one interpretation that commands support from all policy actors. An analytical distinction between competing policy narratives and practices of central banking then requires the analysis to be restricted to the historical evolution of a single central-bank policy space. I have chosen Romania because my command of the language allowed me access to policy documents, speeches, and controversies that otherwise would be more difficult to map. However, the book is built on the premise that the institutionalization of central banks in relation to wider processes of neoliberalization and financialization is no longer a "national" affair. If globalization vs. nation-state dichotomies are abandoned, as Sassen (2003) persuasively argues, then certain components of the nation-state become denationalized. To apply Sassen's arguments in this context, the central bank offers an "institutional home" to global forces, and practices of central banking are reoriented to the requirements of financialization, embedded into complex networks of global governance alongside other supranational (the IMF) or private entities (commercial banks). Such a perspective rescues the analysis from remaining a (hopefully) interesting yet singular case study. Instead, Romania's experience between 1990 and 2008 is useful to identify the features of a financialized approach to monetary management and its inbuilt vulnerabilities that has consolidated in broadly similar forms throughout the region. Furthermore, a comparison of policy responses to crisis in Hungary and

Romania throughout 2009 allows for a reflection on possible politics of resistance to financialized practices.

The politics of central banking: An epistemological note

To argue that monetary policy is political makes no claim to originality. Even Alan Greenspan recognized this in late 2008 when he gave a positive answer to an extraordinary question: "Do you feel that your ideology pushed you to make decisions that you wish you had not made?"[1]. The question (and a positive answer) was extraordinary not only because the "maestro" had a near-mythical status in financial markets but also because it challenged a fundamental premise in monetary policy: the objectivity of technocratic policy-makers. It suggested that, under that cloak of objectivity surrounding monetary policy, lurk questions of power, ideology, and politics.

Furthermore, the political dimension of central banking has been analyzed from different theoretical traditions: from the Marxist approaches embedded in the work of Epstein (2005) or D'Arista (2005) to the neoclassical tradition otherwise impervious to institutional analysis (Alesina 1994). Yet the book approaches the political economy of central banking from a distinct position, seeking to transcend the dichotomy formulation–implementation usually deployed in monetary-policy analysis. Milton Friedman, that anti-government man, saw political interference, usually—although not exclusively—at the stage of implementation, as the greatest threat to rational monetary policy, essentially transgressing a necessary separation between the economic and political spheres. But monetary policy is not political because governments might impose political agendas onto an otherwise objective field of policy formulation, a problem solvable by ensuring adequate central-bank independence (the neoclassicals) or prioritizing the interest of labour (the Marxists). Politics and power are not grafted onto policy but constitutive of it, through processes with actors that mobilize and pursue competing agendas and interests (Keely and Scoones 1999).

The journey of this book started with my interest in central banking in post-socialist Romania. A first question to tackle was how to approach the analysis of monetary policy in a context so profoundly marked by system dislocation. What initially appeared to be a methodological question quickly acquired epistemological dimensions. The challenge was that monetary-policy analysis for Romania resisted the methods deployed in typical economic-policy analysis. Causal relations between relevant variables were difficult to establish empirically since the attempts to construct a capitalist system of production had resulted in repeated economic crisis, as shown in the lengthy relationship with the IMF. Before 1997, for instance, four stand-by arrangements (SBAs) went off-track in less than a year after signing. The SBAs assigned monetary policy an essential role in tackling the crisis; the common explanation of failure contrasted a reform-orientated central bank with vested (political) interests capturing policy implementation (Dragulin and Radulescu 1999).

I was thus searching for an approach that could shed some understanding on these recurrent episodes of crisis and on the role monetary policy had played before, during, and after, particularly against the wider processes of reorganizing the logic of economic production once the Central Plan, the mechanism for allocating resources in socialism, disappeared.

Encountering the work of Karl Niebyl on theories of money provided a first guiding step. An (unjustly) all-but-forgotten economist, in his 1946 *Studies on the Classical Theories of Money*, Niebyl suggested an interesting and innovative historical approach. Any account of central banking should involve three necessary dimensions: monetary theorizing, policy-making, and reality. In a capitalist system of production, Niebyl claimed, monetary theories and policies are embedded in particular institutional structures of the productive and financial sectors. The continuity of an economic doctrine depends on its capacity to anchor itself in the "continuity of reality," in satisfactorily representing and explaining this reality. However, he did not imply that a dominant theory at any one time would necessarily best represent those particular economic conditions: interests and power had to be considered in the process of doctrine formation. In other words, specific institutional configurations, rather than some objective criteria, might shape the theory and policy prescriptions applied to an economic problem[2].

In his methodological approach, Karl Niebyl was a pioneer not only in economics (Chick 1999) but also in policy studies. Indeed, it would be another forty years until questions of interests and power would be systematically addressed in policy analysis. Traditionally, an instrumental view represented policy as a rational problem-solving exercise and attributed to policy-makers control over other policy actors (Mosse 2005). Policy implementation follows the policy model in a linear fashion. Two alternative conceptualizations emerged to question this rationalist representation (Keely and Scoones 1999). The incrementalist perspective depicts policy as the "science of muddling through" through a continuous process of negotiation and bargaining, a perspective that retains the central role of models but acknowledges that implementation might be more complex than initially assumed. A second, more radical view, explicitly links policies with struggles over meaning and interpretation. Drawing on interpretative and critical traditions, this epistemological stance argues that social (and policy) inquiry be conducted through a broader interpretative framework (Fischer 1998).

Indeed, what Fischer calls the argumentative turn in policy analysis emerged in the 1980s against the growing discontent with the rationality project in policy analysis and its "common mission of rescuing public policy from the irrationalities and indignities of politics" (Stone 1988: 12). Under the positivist banner, policy was understood as a "science" concerned with generating predictive generalization and working according to a universal logic of scientific enquiry. Thus policy interventions, "based on causal laws of society and verified by neutral empirical observation" (Dyrzek 1982: 310), would consist of manipulating an array of variables toward achieving certain ends. To ensure a genuine "scientific" approach, empirical enquiry should be stripped of all normative dimensions and rigorously conducted according to the "fact-value dichotomy" by hypothesis testing, data collection, statistical analysis, and value-neutrality (Hawkesworth 1988). Rational policy engineers, technocrats, thus anchor policy knowledge in the confirmation of empirical experience, achieving what Habermas (1989) called the "scientization of politics" or the depoliticization of politics.

Depoliticization works to disguise the importance of discursive struggles in producing policies. Discourse is defined here as "an ensemble of ideas, concepts and categories through which meaning is given to phenomena" (Hajer 1995: 45), that shape and are shaped by social practices and institutions. A dominant interpretation requires a system of inclusion and exclusion: "discourses frame certain problems; that is to say, they distinguish some aspects of the situation rather than others" (Hajer 1995: 45). For instance, monetarist discourses, the economic theory underlying neoliberal approaches to macroeconomic management, view inflation as the consequence of excessive money creation by the central bank (rather than conflicts over the distribution of income or increases in the price of oil), fiscal activism as irremediably inflationary and distortive (rather than a legitimate policy response during crisis of private sector demand), central-bank support of public debt dynamics as inherently inflationary (rather than stabilizing the price of other assets) because it interferes with market allocation, and a tight monetary policy as corrective of price distortions (with little negative impact on output).

That policy is the product of discursive struggles is most apparent during times of crisis. Crises, according to the Slovenian philosopher Slavoj Žižek (2009), are moments of extraordinary politics that disrupt "existing cognitive mappings," leaving instead an ideological struggle over how to interpret events and think about solutions. In other words, policy responses do not develop out of technical, objective analysis of options but are the result of a political struggle over representing the crisis. Hay (1999) drew a Kuhnian analogy between periods of "exceptional" policy-making, when the parameters of what previously defined rational policy change, followed by periods of "normal" policy-making, when a dominant interpretation draws the boundaries of what is possible in policy.

Crisis is thus useful as a conceptual category to map how a dominant construction of the "problem" is stabilized and becomes hegemonic. As the "legitimate" policy issues come under increased contestation, it becomes increasingly apparent that policies are "shaped by competing narratives, informed by divergent interests" (Scoones 2003: 1). Indeed, narratives, defined as vehicles "for transmitting and making accessible a framework of meaning, that is discourse" (Hajer 1995: 23) have long been advocated as a valuable analytical tool for exploring moments of dislocation (Roe 1991). Framing is essential in all policy-making, providing the tools with which narratives are constructed and "cannot be settled by instrumental rationality precisely because it frames that" (Apthorpe and Gasper 1996: 6). By imposing a certain meaning and order onto a series of disjointed events, policy narratives provide a method for creating categories and spaces amenable for interventions, stabilizing the assumptions needed for policy-making while marginalizing competing approaches and closing down policy spaces (Keely 1997). Essential to any policy narrative is its complicity with politics, what Currie (1998) called the ideological function: not what it includes, but what it leaves out of the story.

Thus, Niebyl's (1946) approach will be modified to retrieve the politics of central banking from rationalist representations. Indeed, there is an interesting connection between Karl Niebyl's method of triangulating theory, policy, and reality and discursive approaches to policy analysis. Both view policy as contingent, consolidating through processes that reflect particular institutional configurations, rather than the inevitable product of a rational exercise. Where they differ is in the understanding of "reality," a discrepancy essentially arising from the different