

Central Bank Independence in Southeastern Europe with a View to EU Integration – Revisited

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This contribution updates an analysis of central bank legislation in eight Southeastern European (SEE) countries published in 2004. It uses the ECB classification and examines functional, institutional, personal and financial independence. The relevant Treaty² requirements serve as a benchmark for assessing the degree of legal central bank independence (CBI) already achieved in the respective areas. The author finds that since 2004 some SEE countries have achieved further progress in aligning central bank legislation with Treaty requirements. As in 2004, the degree of CBI continues to correspond largely to the respective country's level of integration with the EU. The main remaining weakness can be found in the area of personal independence, in particular in the provisions on the dismissal of central bank top officials. Further crucial areas are the prohibition of monetary financing and provisions on loss coverage. The paper concludes that legal arrangements to protect the status of the central bank are a necessary, though not sufficient, prerequisite for CBI. In fact, the importance of practical implementation cannot be overestimated.

1 Introduction

The degree of central bank independence (CBI) has substantially increased in Central, Eastern and Southeastern Europe over the past decade. Undoubtedly, a main driving force for this development was (and still is) the ambition of these countries to join the European Union.

The main purpose of this paper is to provide an updated³ overview and analysis of central bank legislation in eight Southeastern European (SEE) countries. The countries examined comprise the new EU Member States Bulgaria and Romania, the EU candidate countries Croatia and the former Yugoslav Republic of Macedonia⁴ as well as the potential EU candidate countries Albania, Bosnia and Herzegovina, Montenegro, and Serbia. The requirements laid down in the Treaty are used as the benchmark for assessing the degree of legal CBI already achieved.⁵ This contribution focuses primarily on developments that have taken place since 2004. These are, among others, amendments to central bank laws in Bosnia and Herzegovina (February 2005), in Bulgaria (April 2005), in Croatia⁶ and in the Republic of Macedonia (both in

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² Treaty establishing the European Communities (1957), as amended by the Treaty of Maastricht (1992) and the Treaty of Amsterdam (1997), referred to as the Treaty hereinafter.

³ In particular, the paper provides an update of the study *Central Bank Independence in Southeastern Europe with a View to Future EU Accession*, which dealt with seven SEE countries at the time (see Dvorsky, 2004). Given Montenegro's independence as of June 2006, the country is now included in the analysis.

⁴ The former Yugoslav Republic of Macedonia (FYROM) will be referred to as the Republic of Macedonia hereinafter.

⁵ In this context, the following caveat has to be made: While harmonizing national central bank legislation with Treaty requirements in most cases leads to an increased level of CBI, this does not necessarily hold in all cases. However, taking into account that all countries analyzed strive to harmonize their central bank legislation with Treaty requirements, the choice of this benchmark seems appropriate.

⁶ In order to fully align central bank legislation with the *acquis communautaire*, Croatia and the Republic of Macedonia intend to adopt another amendment to the Law on the Croatian National Bank in 2007.

December 2006). Furthermore, the paper will touch upon some new developments in the area of “institutionalized assessment” of CBI.⁷

2 Required Scope and Timing of Legal Adjustments

According to Article 109⁸ of the Treaty, “each Member State shall ensure, at the latest at the date of the establishment of the ESCB,⁹ that its national legislation including the statutes of its national central bank (NCB) is compatible with this Treaty and the Statute¹⁰ of the ESCB.” This implies that countries joining the EU after the establishment of the ESCB in June 1998 have to adjust their national legislation in the area of CBI by the date of EU accession (European Central Bank – ECB, 2006b, p. 31, and European Commission 2004d, p. 9). Inter alia, Article 109 refers to the definition of the central bank’s objectives (Article 105 (1) of the Treaty) and to the issue of NCB independence, comprising the freedom from instruction (Article 108 of the Treaty), provisions protecting the legal status of the central bank’s top officials (Article 14 (2) of the Statute) and the financial independence of the central bank (European Monetary Institute – EMI, 1996, pp. 102–103). Article 109 also refers to the prohibition of monetary financing and of privileged access to financial institutions (Articles 101 and 102 of the Treaty, respectively; European Commission, 2004d, pp. 9–12) which the Member States had to implement even before the date of establishment of the ESCB, namely at the beginning of Stage Two of Economic and Monetary Union in January 1994 (Article 116 of the Treaty). These three areas of legislation (definition of the central bank’s objectives, NCB independence and prohibition of monetary financing and of privileged access to financial institutions) are clearly defined as *acquis communautaire* and consequently have to become effective at the latest upon EU accession (“preaccession requirements”).

In addition, Article 109 requires adaptations which relate to the full legal integration of an NCB into the Eurosystem, for instance regulating the adjustment of monetary policy instruments.¹¹ These adaptations (referred to as “integration requirements” in the following) need only enter into force at the date on which the Member State adopts the single currency.¹² On the required timing of enactment of the integration requirements, the European Commission had argued in the past that “new member states are expected to adjust their national legislation as soon as possible after their accession to the EU” and

⁷ This covers regular monitoring activities carried out by the European Commission and the ECB, such as the Opinions on a particular country, the Progress Reports or the Convergence Reports (see Dvorsky, 2005, pp. 72–73).

⁸ In the following, references to particular Articles of the Treaty are made in accordance with the new numbering introduced by the Treaty of Amsterdam in 1997.

⁹ European System of Central Banks (ESCB).

¹⁰ Protocol on the Statute of the European System of Central Banks and of the European Central Bank (1992), referred to as the Statute hereinafter.

¹¹ Article 43.1 of the Statute – in analogy to Article 122 (3) of the Treaty – lists Articles which do not apply to Member States with a derogation. These Articles comprise the adjustment of monetary policy instruments, the mandatory transfer of foreign reserve assets to the ECB, the ECB’s exclusive right to issue banknotes etc. (European Commission, 2004d, pp. 12–13).

¹² It is interesting to note that the Convergence Reports of the European Commission and the ECB not only review the integration requirements, but also the preaccession requirements. The European Commission argues that the convergence assessment covers these areas of legislation, because national legislation could have been amended in the meantime (European Commission, 2004d, p. 9).

“... to ensure compliance in time for the next Convergence Report” (European Commission, 2004d, p. 14). It is noteworthy that the European Commission’s 2006 Progress Reports on the three candidate countries for the first time include the examination of the legal integration requirements, which implicitly qualifies them as preaccession requirements (see European Commission, 2006b, p. 42, 2006c, p. 38, and 2006d, p. 51, respectively).¹³

For comparing and analyzing current central bank legislation in the SEE countries, the ECB’s four-tier classification will be applied, which also provides the analytical framework for examining CBI in the ECB Convergence Reports. Thus, the author will distinguish between the following four aspects of CBI: functional, institutional, personal and financial independence (for detailed definitions, see Dvorsky, 2004, p. 54).

2.1 Statutory Objectives – Functional Independence

The ECB’s concept of functional independence is based on Article 105 (1) of the Treaty and Article 2 of the Statute, according to which the “primary objective of the ESCB shall be to maintain price stability.” As regards the required timing¹⁴ for enactment of these provisions, the ECB takes the view in its Convergence Reports that the obligation of NCBs to have price stability as their primary objective is a preaccession requirement (see ECB, 2006b, p. 31).

Furthermore, Article 105 (1) of the Treaty and Article 2 of the Statute provide for a secondary objective: “Without prejudice to the objective of price stability, it shall support the general economic policies in the Community.” Provisions on the secondary objective are clearly defined as integration requirements. This means, inter alia, that statutory objectives with a “national flavor”¹⁵ have to be adapted upon EU accession, but need to enter into force only upon euro adoption (see ECB, 2006b, p. 32).

Looking at the legislated objectives of central banks in SEE, the situation as described in the 2004 study has remained broadly unchanged: Most central bank laws contain a clearly defined policy objective for the central bank, with six out of eight laws explicitly referring to “price stability” as the primary objective (see table 1). Bosnia and Herzegovina’s law will have to be adapted in this area, as it still makes reference to the “stability of the domestic currency” (see Dvorsky, 2004, p. 55). Montenegro’s central bank law is silent on statutory objectives because it stipulates the euro as the country’s legal tender. Six of the eight SEE central bank laws under consideration also provide for a secondary policy objective. Bulgaria’s amended central bank law contains a stipulation on the secondary objective, which entered into force upon Bulgaria’s EU accession. It refers to the support of general economic policies in the EU, so that the law

¹³ The ECB had traditionally taken a somewhat stricter approach, maintaining that the integration requirements have to be enacted by the date of establishment of the ESCB in Sweden and by May 1, 2004, in the Member States which joined the EU on that date, thus qualifying them as preaccession requirements (see ECB, 2004, p. 30, and ECB, 2006b, p. 43).

¹⁴ The ECB Convergence Report 2004 mentions that the Treaty is unclear as regards the timing of the compliance with the objective of price stability and identifies an inconsistency in the Treaty: While Article 105 (1) of the Treaty does not apply to Member States with a derogation according to Article 122 (3) of the Treaty, Article 2 of the Statute does apply to such Member States.

¹⁵ For example, where national statutory provisions require the NCB to conduct monetary policy within the framework of the country’s general economic policy.

Table 1

Statutory Objectives, Formulation and Implementation of Monetary Policy		
Central Bank	Statutory Objectives – Functional Independence	Formulation and Implementation of Monetary Policy – Institutional Independence
Bank of Albania	<ul style="list-style-type: none"> * "... to achieve and maintain price stability." (Article 3.1) * other objectives, subordinated to price stability (Articles 3.2 and 3.3) 	<ul style="list-style-type: none"> * "... formulate, adopt and execute the monetary policy ..." (Article 3.4a) * "... formulate, adopt and execute ... the exchange rate policy" (Article 3.4b) * freedom from instruction (Article 1.3)
Central Bank of Bosnia and Herzegovina	<ul style="list-style-type: none"> * "... to achieve and maintain stability of the domestic currency ..." by applying a currency board arrangement (Article 2.1) 	<ul style="list-style-type: none"> * "... to formulate, adopt and control monetary policy by issuing domestic currency at the exchange rate determined in Article 32 ..." (Article 2.3a) * freedom from instruction (Article 3)
Bulgarian National Bank	<ul style="list-style-type: none"> * "... to maintain price stability ..." (Article 2.1) * without prejudice to the primary objective, the Bank shall support general economic policies in the EU, upon Bulgaria's EU accession (Article 2.2) * without prejudice to Articles 2.1 and 2.2, the BNB "shall support the policy of sustainable and noninflationary growth" (Article 2.3) 	<ul style="list-style-type: none"> * detailed definition of currency board regime (Article 28) * fixed exchange rate (Article 29) * freedom from instruction (Articles 44, 1.2, 50 and 51)
Croatian National Bank	<ul style="list-style-type: none"> * "... to achieve and to maintain price stability" (Article 3.1) * "... without prejudice to its primary objective, the Bank shall support economic policies ..." (Article 3.2) 	<ul style="list-style-type: none"> * "establish and implement the monetary and foreign exchange policies" (Article 8.1) * freedom from instruction (Article 2.10, amended in December 2006)
National Bank of the Republic of Macedonia	<ul style="list-style-type: none"> * "... to maintain price stability" (Article 3) * the Bank shall support economic policy and financial stability without jeopardizing its main objective (Article 3) 	<ul style="list-style-type: none"> * the bank shall "establish and conduct the monetary policy" (Article 10) * the bank shall "establish and conduct the exchange rate policy" (Article 20) * in case of lack of consent by the National Bank Council, the final decision is taken by parliament (Article 67) * the decision on monetary policy objectives has to be submitted to parliament (Article 54) * freedom from instruction (Article 4)
Central Bank of Montenegro	no provision	<ul style="list-style-type: none"> * the bank is responsible for monetary policy, a sound banking system and an efficient payment system; monetary policy is based on the euro as a monetary unit, payment instrument as well as a reserve currency (Article 1) * the central bank may not issue money (Article 3)
National Bank of Romania	<ul style="list-style-type: none"> * "... to ensure and maintain price stability" (Article 2.1) * "Without prejudice to its primary objective, the NBR shall support general economic policy" (Article 2.3) 	<ul style="list-style-type: none"> * "... to define and implement the monetary policy and exchange rate policy" (Article 2.2a) * "define and implement exchange rate policy" (Article 9.1) * freedom from instruction (Article 3.1)
National Bank of Serbia	<ul style="list-style-type: none"> * "... achieving and maintaining price stability" (Article 3) * "... in addition, ... striving for financial stability" (Article 3) * "Without prejudice to its primary objective, the Bank shall support economic policy" (Article 3) 	<ul style="list-style-type: none"> * "... determine and implement monetary policy" (Article 4.1) * "... determine exchange rate regime with the consent of the government" (Article 4.2) * ex ante submission of the monetary policy program to parliament for information (Article 71) * freedom from instruction (Article 2)

Sources:

- Law 8269 on the Bank of Albania. 1997. December 23.
 Law 312 on the Statute of the National Bank of Romania. 2004. June 28.
 Law on the Bulgarian National Bank. 1997. June 10.
 Law on the Central Bank of Bosnia and Herzegovina. 1997. June 28.
 Law on the Central Bank of Montenegro. 2000. November.
 Law on the Central Bank of the Republic of Turkey. No. 1211. 1970. January 14.
 Law on the Croatian National Bank. 2001. April 5.
 Law on the National Bank of the Republic of Macedonia. 2002.
 Law on the National Bank of Serbia. 2003. July 19.
 Data compiled by the author.

Note: The central banks are referred to by their English designation.

is now in full compliance with integration requirements as well. The wording of the Serbian central bank law still carries a potential of conflicting goals for monetary policy, stipulating that the central bank shall strive for financial stability without giving clear precedence to the objective of price stability (also see Dvorsky, 2004, p. 55). To sum it up, regarding primary statutory objectives, the laws in most SEE countries are largely in line with the Treaty, whereas for secondary objectives, in most SEE countries will still need adaptations.¹⁶

2.2 Formulation and Implementation of Monetary Policy – Institutional Independence

The ECB's definition of institutional independence is based on Article 108 of the Treaty and Article 7 of the Statute (ECB, 2006b, p. 31). These provisions prohibit the ECB, the NCBs and the members of their decision-making bodies to take or seek instructions from Community institutions or bodies, from any government of a Member State or from any other body. This paper takes a broader approach and examines – in addition to the issue of freedom from instruction – whether the central bank laws under consideration endow their central banks with the necessary competences to formulate and implement monetary policy in order to achieve the primary objective independently.

As to institutional independence according to the ECB's definition, the freedom from instruction is explicitly stipulated by six of the eight SEE central bank laws (see table 1). Compared with the situation in 2004, the only change in this area was a rewording of the Croatian central bank law in order to fully comply with Treaty requirements (see Article 2.10 of the amended Croatian law). In some other SEE countries, the main weaknesses identified in 2004 have remained unchanged. In particular, the legislation of the Republic of Macedonia and of Serbia oblige the central banks to submit their monetary policy program *ex ante* to the parliament, which potentially implies political influence on monetary policy decisions taken by the central bank. Furthermore, the parliament of the Republic of Macedonia has a final say if the National Bank Council cannot achieve the necessary majority for decision-making. However, the prohibition of external influence on the central bank as understood by the ECB covers all possible sources of influence, both at the national level (government, parliament) and at the EU level (Community institutions or bodies) as well as different forms of influence (the right to give instructions, to approve, suspend, annul, defer or censor decisions).¹⁷ According to this very strict interpretation of institutional independence, the wording of several SEE laws will have to be further adapted.

Pursuant to Article 105 (2) of the Treaty and Article 3.1 of the Statute, one of the ESCB's basic tasks is to define and implement the monetary policy of the Community. Most SEE central bank laws contain provisions that vest the

¹⁶ In this context, it is worth mentioning that also some EU Member States were criticized in the latest Convergence Reports of the ECB and the European Commission as regards secondary objectives (see ECB, 2006b, p. 223 on Hungary and p. 229 on Poland as well as European Commission, 2006a, p. 64 on Hungary, p. 91 on Poland, p. 104 on Slovakia and p. 118 on Sweden).

¹⁷ As a case in point, the European Commission's Convergence Report 2004 identified a number of weaknesses and imperfections in the respective sections on institutional independence in some Member States' central bank laws (see e.g. European Commission, 2004d, p. 118 on Sweden). In a similar vein, the ECB's Convergence Report 2006 examined institutional independence in a rather strict sense (ECB, 2006b, p. 227 or p. 232).

respective NCBs with the formal responsibility to design and implement monetary policy in their countries (see table 1). Bulgaria as well as Bosnia and Herzegovina operate currency board arrangements which leave no room for the central banks to independently design monetary policy (apart from changes in mandatory reserve requirements). In Montenegro, which does not pursue national monetary policies, the central bank's functions are even more limited.

To sum it up, Bulgaria and Croatia have achieved some progress in the area of institutional independence, while in particular the legislation of the Republic of Macedonia and of Serbia still need to be adjusted substantially.

2.3 Personal Independence

The definition of personal independence is largely undisputed and relates to arrangements on the role, status and composition of the central banks' highest decision-making bodies. This includes appointment procedures, the length of the term of office and the possibility of renewing a mandate, rules for dismissal, requirements regarding professional competence and incompatibility clauses.

While the Treaty and the Statute contain appointment procedures for the members of the Executive Board of the ECB, these provisions do not relate to the appointment of NCB top officials. Therefore, institutionalized assessments remain silent on national appointment procedures. Like in 2004, the most common procedure to appoint central bank governors in SEE is election by parliament. The legal provisions for the appointment procedures for other members of the highest decision-making bodies differ considerably in the SEE countries, both between countries and between different positions. Bosnia and Herzegovina is a special case, as the appointment procedures for the central bank's highest decision-making body are based on the Dayton Peace Agreement. The recent amendment of Croatia's national bank legislation entailed a change in the composition of the Council of the Croatian National Bank, requiring all Council members to be full-time employees of the central bank.¹⁸

According to Article 14.2 of the Statute, the minimum term of office required for NCB governors is five years. These rules for the security of tenure of office should equally apply to the other members of the NCBs' decision-making bodies (see e.g. ECB, 2006b, p. 26). With respect to the legal requirements regarding the length of tenure for top officials, the situation in SEE has remained unchanged since 2004, with all analyzed central bank laws being in line with Treaty requirements (see table 2).

A related question is the issue of renewal of the mandate: The possibility of reappointment of top officials is generally seen as decreasing the level of CBI. The Statute specifies that members of the Executive Board of the ECB may not be reappointed, whereas it does not contain any rule on the reappointment of NCB governors. Reappointment of central bank governors and, in some cases,

¹⁸ Currently, the Council of the Croatian National Bank comprises the Governor, the Deputy Governor, four Vice Governors and eight external members. The transitional provisions of the amendment stipulate that the external members' term of office will end upon Croatia's EU accession. The Deputy Governor will become a Vice Governor and the remaining three Vice Governors will have to be appointed by parliament within 30 days of EU accession.

Table 2

Personal Independence of Central Banks in SEE – Part 1

	Governor		Highest Decision-Making Body		Dismissal	Incompatibility Clauses
	Term of Office	Appointment	Composition and Term of Office	Appointment		
Bank of Albania	* 7 years * reappointment possible (Article 44.4)	* appointed by parliament, on proposal of state president (Article 44.2c)	* Supervisory Council (SC): 1 governor, 2 deputy governors, 6 other members (Article 44.1) * term of office: 7 years, reappointment possible (Article 44.4)	* appointed by parliament, 5 members proposed by parliament, 3 by council of ministers, 1 by SC (Article 44.2)	* criminal act, bankruptcy, personal misconduct, political activities (Article 47.1) * absence from 2 SC meetings, inability to perform, serious misconduct (Article 47.2)	SC membership incompatible with (Article 46): employment by or holding significant shares of a commercial bank or other institution licensed by the Bank of Albania
Central Bank of Bosnia and Herzegovina	* 6 years * reappointment possible (Article 8.4)	* governor appointed by members of Governing Board (Article 8.2b)	* Governing Board: 5 members (Article 8.2a) * term of office: 6 years, reappointment possible (Article 8.4)	Governing Board members appointed by the presidency (Article 8.2a)	* violation of currency board arrangement rule, criminal act, bankruptcy, personal misconduct (Article 11.1a–e) * inability to perform, absence from more than half of Governing Board meetings in previous year (Article 11.2)	Governing Board membership incompatible with appointment/election (Article 10): * presidency * parliament * constitutional court * government
Bulgarian National Bank	* 6 years (Article 12.4)	* elected by parliament (Article 12.1)	* Governing Council: 1 governor, 3 deputy governors, 3 other members (Article 11.1) * term of office: 6 years (Article 12.4)	* 3 deputy governors elected by parliament, on governor's proposal (Article 12.2) * other 3 members appointed by president of state (Article 12.3)	* inability to perform functions for more than 6 months * serious misconduct * conditions required under Article 11.4 no longer fulfilled (Article 14.1)	* governor and deputy governors shall not perform any other remunerated activity (Article 12.5) * other 3 members: no other activity at the BNB or other financial institutions, no activity in the executive branch (Article 12.6) * all members: imprisonment, bankruptcy, member of managing or supervisory body of company 2 years before insolvency of company (Article 11.4)
Croatian National Bank	* 6 years (Article 40.5)	* appointed by parliament, on proposal of parliamentary committees (Article 40.1)	* Council: 1 governor plus 8 vice-governors (Articles 38.1 and 40.2) * term: 6 years (Article 40.5)	* vice governors appointed by parliament on proposal of parliamentary committees (Article 40.3)	* incompatibility according to Article 41 * criminal act * serious misconduct or lack of moral or professional integrity according to Council * inability to perform * false statements related to Article 41 (Article 42.1a–f)	* Council members "... shall be full-time employees ..." (Article 41.1) Council membership incompatible with position in: * parliament, government, local government, trade union, political party (Article 41.2) * ownership or management position in commercial banks (Articles 41.2, 41.3)

Table 2

Personal Independence of Central Banks in SEE – Part 2						
	Governor		Highest Decision-Making Body		Dismissal	Incompatibility Clauses
	Term of Office	Appointment	Composition and Term of Office	Appointment		
National Bank of the Republic of Macedonia	* 7 years, one reappointment possible (Article 70)	* appointed by parliament, on proposal of state president (Article 70)	* National Bank Council: 1 governor, 2 vice governors, 6 external members (Article 57) * term of office: 7 years (Articles 60 and 72)	* vice governors appointed by parliament on proposal of governor; one reappointment possible (Article 72) * external members appointed by parliament on proposal of state president, no reappointment (Article 60)	* criminal act * ban of practicing profession * illness * inability * performing functions dishonestly, unprofessionally, etc. * decision on dismissal plus explanatory note shall be published (Articles 60 and 70)	NBC membership incompatible with, inter alia (Article 58): * position in commercial banks * trade union membership * net debtor of a bank status * criminal sentence (waiting time) * party membership
Central Bank of Montenegro	* 6 years, 1 reappointment possible (Article 16)	* appointed by parliament, on proposal of parliamentary committee (Article 14)	* Council: 1 president, 1 general manager, 2 deputy general managers, 3 members (Article 14) * term of office: 6 years, 1 reappointment possible (Article 16)	* members of the Council appointed by parliament; * 1 president, 1 general manager, 2 deputy general managers on proposal of parliamentary committee; * 3 other members proposed by government (Article 14)	* nonfulfillment of professional qualifications * bankruptcy procedure * conviction of crime * performing functions unprofessionally and unconscientiously * loss of ability to perform functions (Article 23)	Council membership incompatible with: * employment by a bank or ownership of more than 5% of a bank in Montenegro * conviction for criminal offenses (Article 15) * occupation of any other office or employment (Article 64a)
National Bank of Romania	* 5 years, reappointment possible (Article 33.4)	* appointed by parliament, on proposal of parliamentary committees (Article 33.3)	* Board: 1 governor, 1 senior deputy governor, 2 deputy governors, 5 external members (Article 33.2) * term of office: 5 years, reappointment possible (Article 33.4)	* appointed by parliament, on recommendation of parliamentary committees (Article 33.3)	* inability * serious misconduct (Article 33.6)	Board members have to work on full-time basis (Article 34.4) Board membership incompatible with appointment/election inter alia (Article 34): * parliament * political affiliation * public administration
National Bank of Serbia	* 5 years, reappointment possible (Article 16)	* appointed by parliament, on proposal of parliamentary committee (Article 16)	* Monetary Board: 1 governor; 3 to 5 vice governors (Article 13, Article 19)	* vice governors appointed by the NBS Council, on proposal of governor; reappointment possible (Article 19)	* criminal act * incompetence, mistakes * inability to perform functions with regard to Article 28 (Article 30)	Monetary Board and Council membership incompatible with appointment/election inter alia (Article 28): * parliament * government * local government * trade union membership * bank management or ownership

Source: See table 1.

of other top officials, is possible in most SEE countries, while no explicit reference can be found in the central bank laws of Bulgaria and Croatia.¹⁹

The most disputed area in the field of personal independence concerns the rules for removal from office of central bank top officials. According to Article 14.2 of the Statute, NCB governors may only be dismissed for the following reasons: if they no longer fulfill the conditions required for the performance of their duties or if they have been guilty of serious misconduct. The ECB argues that these rules should also pertain to the other members of the NCBs' decision-making bodies (see ECB, 2006b, pp. 33–34). Since 2004, provisions on the dismissal of the highest decision-making bodies' members have been amended in Bulgaria, Croatia and the Republic of Macedonia. Yet none of these amendments has been judged by the European Commission to be sufficient to ensure full compliance with Treaty requirements, so that currently only Romania's central bank law is fully in line with the Treaty in this area (European Commission, 2005d, p. 51). In Bulgaria, the amended central bank law limits the reasons for dismissal to the two reasons stipulated by Article 14.2 of the Statute. However, Article 14.1 of the amended Bulgarian law still makes reference to Article 11.4 of the same law, which defines persons who may not become members of the Governing Council, thus indirectly introducing three additional reasons for dismissal. While the Bulgarian National Bank (BNB) defended this amendment, stating that it reduces the reasons for dismissal to a maximum extent (see Grozev, 2006, p. 123), the European Commission gave a critical assessment on this amended provision in its Comprehensive Monitoring Report 2005, requiring some "minor adjustments ... concerning the dismissal of members of the Governing Council ..." (European Commission, 2005b, p. 47).²⁰ In this context, it is interesting to note that legal provisions on reasons for dismissal are also not undisputed in some other EU Member States.²¹ In the most recent amendment of the Croatian central bank law, one provision on possible reasons for dismissal was deleted while several others were retained after the European Commission had criticized them in its Progress Report 2005 on Croatia (see European Commission, 2005c, p. 74). The provision is still not in line with Treaty requirements and will have to be further adapted. In a similar vein, the recent amendment of the central bank law of the Republic of Macedonia seems to be a reaction to the criticism expressed by the opinion on the Republic of Macedonia in this area (European Commission, 2005a, p. 91). Articles 60 and 70 of the amended law provide for the publication of an explanatory note in the case of a dismissal decision. While this provision can be seen as increasing the transparency of such decisions, it seems doubtful whether it will be assessed as complying with Treaty requirements. For the other SEE central bank laws,

¹⁹ In particular, Article 11.4 of the Bulgarian central bank law defines persons who may not become members of the Governing Council as persons "sentenced to imprisonment ...," "adjudicated in bankruptcy ..." and "previous members of a managing or supervisory body of a company ..." before its insolvency."

²⁰ As a case in point, the ECB's Convergence Report 2006 gives a critical assessment on legislation in the Czech Republic, Latvia, Poland, Slovakia and Hungary (see ECB, 2006b, p. 210, p. 219, p. 228, p. 230 and p. 222, respectively).

²¹ The absence of a provision on reappointment, however, implies that reappointment of top officials is possible. As a case in point, Zelko Rohatinski was reappointed as central bank governor of the Croatian National Bank in June 2006.

the need for adjustments is considerable. Currently legislated reasons for dismissal in Albania, Bosnia and Herzegovina, Montenegro, and Serbia are likely to be criticized by the European Commission in the future.

2.4 Financial Independence

As in 2004, the author uses a broad definition of the term “financial independence.” It covers two aspects: first, budgetary independence (comprising rules on the management of the central bank’s budget, ownership issues, allocation of central bank profits and coverage of potential losses) and second, the issue of prohibition of monetary financing, given its importance for CBI. Interestingly, this issue has not always been included in the Convergence Reports. In fact, the European Commission included the examination of the prohibition of monetary financing for the first time in its 2004 Convergence Report (see European Commission, 2004, p. 9), the ECB followed in 2006 (see ECB, 2006a, pp. 67–68 and ECB, 2006b, pp. 28–30, respectively).²² As will be shown below, the issues of budgetary and financial independence are closely interrelated.

While the Treaty and the Statute do not contain explicit provisions on the NCBs’ budgetary independence, the ECB argues that a fully independent NCB should be able to avail itself autonomously of the appropriate economic means to fulfill its mandate and – after EU accession – to perform its ESCB-related tasks (see ECB, 2006b, p. 36). In particular, ex ante influence on an NCB’s financial means by external bodies is regarded as jeopardizing the NCB’s independence, while ex post reviews of its financial account may be seen as a reflection of accountability (ECB, 2006b, p. 37).

As in 2004, all SEE central bank laws stipulate that the central bank’s budget is managed by the bank’s highest decision-making body independently from any government institution (see table 3). Amendments pertaining to the allocation of profits have been enacted by Bosnia and Herzegovina and by the Republic of Macedonia. The amended central bank law of Bosnia and Herzegovina abolished the special reserves and – after the allocations to the general reserves – provides for a 40% share of remaining profits to be allocated to the bank’s reserves instead.²³ The amended legislation of the Republic of Macedonia brought about an increase in the share of profits to be allocated to the central bank’s general reserves.²⁴

While provisions on profit allocation are largely unproblematic in terms of CBI, the European Commission argues that provisions on the coverage of potential central bank losses may in some cases involve a form of monetary financing. In particular, if the central bank’s losses may be covered by a transfer of government securities from the budget to the central bank’s balance sheet and these securities have to be redeemed from the central bank’s profit in the

²² The logic of this approach was that – according to Article 116 of the Treaty – the prohibition of monetary financing and privileged access is a Stage Two requirement. It is worth noting that the issue is dealt with separately from NCB independence issues by the Convergence Reports.

²³ Prior to the amendment, profits had to be allocated to general reserves up to a specified maximum amount. The remaining part could be used for building up special reserves with no specified upper limit. Only the remaining part of profits had to be transferred to the fiscal authorities (see Dvorsky, 2004, p. 61).

²⁴ While formerly only 20% of the central bank’s net income had been allocated to the bank’s general reserves, this share was increased to 70%.

Table 3

Financial Independence of Central Banks in SEE

	Limits to Government Lending		Budgetary Independence		
	Direct Credit	Indirect Credit	Ownership and Management of Budget	Allocation of Profit	Coverage of Potential Losses
Bank of Albania	* loans with a maturity of up to 6 months permitted (Article 30.2) * maximum: 5% of average budgetary revenues of past 3 years (Article 30.4), waiver: 8% of revenues (Article 30.5)	purchases of government securities in the secondary market permitted (Article 32)	* capital owned by the state (Article 6.3) * budget determined by Supervisory Council (Article 43.n)	* 25% of profits allocated to general reserve fund up to 500% of paid-up capital (Article 9) * repayment of previous loss coverage (Article 10.1) * residual profits paid to state budget (Article 10.2)	net losses covered by Ministry of Finance (Article 7)
Central Bank of Bosnia and Herzegovina	prohibited (Article 67.1)	prohibited (Article 67.1)	* budget determined by Governing Board (Article 7.j)	* profits allocated to general reserve so that initial capital plus general reserve equal 5% of monetary liabilities (Article 27a) * remaining profit: 40% allocated to increase of general reserve, 60% to fiscal authorities (Article 27b)	* net losses covered by general reserve (Article 28b) * residual covered by the Ministry for Budget (Article 29b)
Bulgarian National Bank	prohibited (Article 45.1)	prohibited (Article 45.1)	* approval of annual budget by Governing Council (Article 16.13) * the BNB addresses the approved annual budget to parliament (Article 50)	* 25% of profits allocated to reserve fund (Article 8.2) * necessary amounts to be allocated to special funds (Article 8.3) * residual to state budget (Article 8.4)	* losses covered by reserve fund and special reserve account of BNB (Articles 8 and 9) * residual covered by Ministry of Finance (Article 9.1)
Croatian National Bank	prohibited (Article 36.1)	purchases of government securities in the secondary market permitted (Article 36.3)	* capital held exclusively by state (Articles 2.9 and 50.2) * Council adopts financial plan (Article 38.3b)	* profits allocated to general reserves within defined limits (Article 53.2) * residual to state budget (Article 53.3)	* losses covered by general reserves (Article 53.4)
National Bank of the Republic of Macedonia	prohibited (Article 51)	no provision	* sole state ownership (Article 5) * National Bank Council adopts financial plan (Article 64.4)	* unrealized income from price and exchange rate fluctuations allocated to revaluation reserves * 70% of residual amount allocated to general reserves until level of core capital is reached and up to 15% after core capital was reached * residual to state budget (Article 89)	* losses covered by general reserves * residual covered by state budget (Article 89a)
Central Bank of Montenegro	prohibited "except under certain conditions" (Article 3)	purchases of government securities in the secondary market permitted (Article 33a)	* annual financial plan adopted by the Council and furnished to government for information only (Article 56)	* general reserves, up to 5% of total amount of credit balances (Article 54) * residual to state budget (Article 54)	* losses covered by general reserves or by founding capital, in that order (Article 54)
National Bank of Romania	prohibited (Article 6.1 and Article 29.1)	purchases of government securities in the secondary market permitted (Article 6.3)	* capital owned by state (Article 38.1) * annual budget approved by the Board (Article 41)	* 80% of profit allocated to state budget (Article 43.1) * residual to statutory reserves, own financing sources and employee profit-sharing scheme (Article 43.5)	* losses covered by special revaluation account and statutory reserves (Article 44)
National Bank of Serbia	* permitted to cover "temporary illiquidity of the budget" (Article 39.1) * maximum 5% of average budget revenue of past 3 years (Article 39.2)	no provision	* Council adopts financial plan on proposal of governor (Article 24.1) * Governor decides on use of special reserves (Article 78) * ex ante submission of financial plan for following year to the parliament (Article 80)	* maximum of 30% of surplus allocated to special reserves * residual to state budget (Article 77)	* losses covered by special reserves * residual covered by state budget (Article 77)

Source: See table 1.

following years, this may potentially involve a form of monetary financing “to the extent that the central bank is obliged to acquire them” (see e.g. European Commission, 2004, p. 82, on Croatia or 2005a, p. 91, on the Republic of Macedonia). In order to comply with the Commission’s requirements in this area, the amendment to the Croatian central bank law deleted these potentially problematic provisions. The Bulgarian central bank law – which had been criticized in the 2004 Progress Report for containing a similar provision (European Commission, 2004b, p. 79) – was also amended and is now in full compliance with Treaty requirements in this field. The central bank laws of Albania and Serbia contain similar provisions on the coverage of losses, which by analogy are not compatible with Treaty requirements either.

As to the prohibition of monetary financing, the legal basis can be found in Article 101 (1) of the Treaty, as restated in Article 21.1 of the Statute, which stipulates that overdrafts or any other type of credit facility with the ECB or with the NCBs in favor of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States are prohibited, as is the purchase directly from them by the ECB or NCBs of debt instruments.²⁵ The Treaty does not contain a prohibition of indirect central bank credit. As compared with 2004, the situation has remained broadly unchanged in this area: Five of the eight SEE central bank laws analyzed explicitly prohibit direct central bank lending (see table 3). Major adjustments will be necessary in Albanian and Serbian legislation in the area of direct central bank credit (for details, see Dvorsky 2004, p. 63), while clarification may be needed on the provisions of Montenegro.²⁶ Furthermore, a number of smaller adjustments will be necessary in the other SEE laws to achieve full compliance with Treaty requirements (see e.g. Dvorsky, 2005, p. 84, on the Republic of Macedonia).

3 Conclusions

Since 2004, some SEE countries have achieved further progress in aligning central bank legislation with Treaty requirements. As in 2004, the degree of CBI continues to correspond largely to the respective country’s level of integration with the EU.²⁷

Looking at the legal aspects of CBI in more detail, the results can be summarized as follows: First, a main weakness can be still found in the area of personal independence, in particular as regards the provisions on the dismissal of central bank top officials, notwithstanding recent amendments in this area. Second, the prohibition of monetary financing is a highly crucial issue: While direct central bank credit is prohibited in five of the eight countries examined, major adjustments are necessary in Albania and Serbia and smaller ones in

²⁵ *Complementary to the prohibition of direct central bank lending to the government, Article 102 (1) of the Treaty prohibits privileged access of public authorities to financial institutions.*

²⁶ *In particular, the phrase “except under certain conditions” in Article 3 is likely to be questioned and will have to be removed in order to comply with Treaty requirements.*

²⁷ *This is very similar to the overall state of structural reforms in SEE countries: As a case in point, the European Bank for Reconstruction and Development (EBRD) Transition Report finds that in 2006 the biggest progress was achieved by Bulgaria, Croatia and Romania, where the European Commission’s pressure to fulfill accession requirements seems to have played a crucial role. Of the remaining five SEE countries, the Republic of Macedonia was found to be the leading reformer (see EBRD, 2006, pp. 2–12).*

several other countries. Third, the provisions on loss coverage still have to be adapted in a number of countries. Fourth, regarding institutional independence, most central banks in SEE are vested with the formal responsibility of designing and implementing monetary policy in their countries. Special cases are the currency board arrangements in Bulgaria as well as Bosnia and Herzegovina, and the unilateral euroization of Montenegro. Fifth, in the field of functional independence, the legal provisions in most SEE countries regarding primary objectives are largely in line with Treaty requirements.

While a central bank's legal status provides an important benchmark for assessing CBI in the respective country, it has to be emphasized that the actual implementation of central bank legislation plays an equally important role.²⁸ Legal arrangements to protect the status of the central bank are a necessary, though not sufficient, prerequisite for CBI. In fact, the importance of practical implementation cannot be overestimated.

Cutoff date for data: January 31, 2007.

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²⁸ A case in point is the history of appointments and withdrawals of central bank governors in SEE countries. The analysis clearly shows that in practice, the central banks were not free from political interference (see Dvorsky, 2004, pp. 69–71, and Dvorsky, 2007). Furthermore, the political readiness of national parliaments to change the central bank law in the sense of decreasing the level of CBI turns out to be a crucial issue.

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