Central Bank Independence in Transition: Legislation and Reality in Central and Eastern Europe

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1 Introduction

In the recent past, the concept of central bank independence (CBI) has become increasingly recognized, especially in the Member States of the European Union, where the Maastricht Treaty was the driving force for a further strengthening of CBI, but also in a number of other countries that are amending their central bank laws accordingly.

The introduction of central bank independence constituted an important element in the political and economic transformation process in Central and Eastern Europe and was part and parcel of fundamental financial sector reform. Meanwhile, a number of reforming countries have concluded Association Agreements with the European Union and have officially applied for EU membership. Therefore, the issue of further strengthening central bank independence in order to fulfill the requirements of the Maastricht Treaty has gained even more importance. The main purpose of this paper is to examine the degree of legal CBI already achieved by the Central and Eastern European countries (CEECs)[2]), and to compare it to the standards set by the Maastricht Treaty.[3]) In a second step, we want to analyze how CBI is implemented in practice and what role the central bank de facto plays in the context of the overall reform program.

Under the system of central planning, central banking and commercial banking functions were typically concentrated at a monobank, which basically "functioned as a department of the finance ministry" with the sole objective of fulfilling the overall central plan.[4]) Therefore, the first step of financial sector reform was the transition from a monobank to a two-tier banking system, where central bank departments and branches which had previously performed commercial banking functions were separated from the monobank and established as commercial banks. Unlike under the centrally planned regime, the newly adopted central bank laws[5]) endowed the central banks with monetary policy competences and a considerable degree of legal independence, thus de jure transforming them into key players of economic policy in the context of comprehensive macroeconomic stabilization programs. At the same time, some of the examined countries, such as Slovenia and Slovakia, had to face the enormous task of institution-building[6]), because they had no history of central banks of their own and hence had to build up their national central banks from scratch. Central banking expertise had to be acquired within a very short span of time.[7]) The adoption of modern central bank laws at the outset of the reforms was followed by a number of amendments in most countries,[8]) further strengthening the autonomy of the central banks mainly in view of meeting the requirements of the Maastricht Treaty. As compared to Western countries, protecting the central bank from political pressures might have been even more important in transition economies, where reform-induced price shocks (due, e.g., to price liberalization, initial devaluations of the nominal exchange rate and the introduction of VAT) gave rise to demands for an accommodating monetary policy stance, thus increasing the temptation to bend the law.[9]) Despite a relatively high degree of legal CBI in most transition economies, the actual implementation of existing laws has to be examined, focusing on the degree of actual CBI and the role of the central bank in practice.

2 The Role of the Central Bank in the Overall Economic Framework

There is a bulk of literature on the theoretical foundations of CBI.[10]) An economically useful distinction of CBI was provided by Stanley Fischer, who defined the categories of goal independence and instrument independence.[11]) According to this definition, a central bank with imprecisely defined or undefined policy goals enjoys goal independence, as it is able to set its policy goals autonomously. On the other hand, a central bank with a clearly defined mandate (e.g. price stability) has instrument independence, if it has full power to develop and use monetary policy instruments in order to achieve the given goal. It is widely acknowledged in the literature that central banks should be endowed with instrument independence, but should not have goal independence. If the central bank can autonomously choose its policy goal regardless of the overall economic conditions, this would bring about a suboptimal result in terms of general economic performance. Therefore, most experts recommend that the central bank law clearly define a goal which has top priority for the central bank and for which the central bank can be held accountable in order to ensure democratic legitimacy. As regards the development of monetary policy strategies and the choice of instruments, the central bank should be endowed with a high degree of independence from any government body and must not be subject to instructions in fulfilling the tasks assigned to it by law.

One of the most prominent arguments why central banks should be independent is the time-inconsistency approach,[12]) which is based on the assumption that central bankers generally take a longer-term view and are more concerned about inflation than government officials who strive to be reelected and therefore tend to prioritize short-term policy goals such as high output growth, high employment levels or high fiscal revenues. This argument is in a way a reflection of the Phillips curve model, according to which there is a trade-off between inflation and unemployment in the short run. Therefore, endowing an inflation-averse central bank with a high degree of independence from the government immunizes the central bank against politically motivated desires for monetary expansion and helps to stabilize expectations on price developments. An alternative approach to CBI refers to the principal/agent concept, according to which the principal (government) signs a contract with its agent (the central bank).[13]) In this contract, the agent is made responsible for the achievement of a defined inflation target.[14]) Persson and Tabellini[15]) show that an optimal central bank contract may serve to eliminate the inflation bias while still preserving the advantages of stabilization.

The major objection to “perfect” CBI[16]) refers to the need of coordination between monetary policy and fiscal and incomes policies. It is argued that “perfect” CBI could be interpreted in the sense of noncoordination between government and the central bank, which leads to suboptimal overall economic results.[17]) We have to bear in mind that a high degree of CBI does not per se guarantee an anti-inflationary consensus in a country. In order to achieve the long-term goal of price stability at the lowest possible cost, it is desirable to ensure a broad political consensus which is supported by the

main players of economic policy, including not only the government but also the parties in the wage-setting process. This consensus could be embedded in an appropriate institutional framework, a widely known example being the Austrian model of social partnership.[18]) In our view, this coordination of economic policies does not contradict the requirement that the central bank must be free from instructions from government bodies. A high degree of CBI does not automatically mean that there should be no exchange of information or discussion between the central bank and other economic policymakers. On the contrary, a broad anti-inflationary consensus is a precondition to successfully achieving the long-term goal of price stability at a low cost. The relationship between measured CBI and the sacrifice ratio, the latter being defined as the output loss per unit of disinflation, was recently examined by Andreas Fischer.[19]) He showed a potential trade-off, namely that industrialized countries with a high degree of CBI have higher sacrifice ratios than those with less autonomous central banks. Another important objection to "unlimited" CBI refers to the requirement of central bank accountability to a democratically elected body, which may imply a certain limitation of CBI.[20]) The criticism voiced by American political scientists like Edward Luttwak against "central bankism" points in a similar direction.

The empirical CBI literature has focused on the measurement of both legal and actual CBI as well as on the relationship between the measured degree of CBI and different economic variables, especially inflation, but also real output growth, the unemployment level, etc. The pioneering work in measuring CBI was written by Bade and Parkin[21]) in 1980, who for the first time compiled several aspects of legal CBI for the central banks of twelve industrialized countries. Alesina[22]) extended this analysis in 1988 and 1989 to another four industrialized countries and slightly modified the overall ranking of the examined central banks. A more comprehensive index was developed by Grilli et al.,[23]) who examined two dimensions of independence: political independence (appointment of the top officials, relations with the government, etc.) and economic independence (limits of lending to the government, choice of monetary policy instruments) for 18 industrialized countries. Eijffinger and Schaling (1993) constructed an index reflecting the number of government officials on the bank board, the appointment of the bank board and the location of final monetary policy authority and used it for twelve industrialized countries.[24]) The most comprehensive approach to measuring CBI was undertaken by Cukierman[25]), who, in a first step, created an index for the degree of legal CBI and tested it for almost 70 industrialized and developing countries.[26]) In a second step, Cukierman introduced a proxy to measure the degree of actual CBI, namely the turnover rate of central bank governors, and applied it to 55 industrial and developing countries in the years 1950 to 1989. An additional method used by Cukierman to measure actual CBI was the processing of answers to a questionnaire which had been distributed among central banks. The questions were primarily related to the actual implementation of legal stipulations and to deviations from legal regulations in practice.

While a number of models have been developed to measure the degree of CBI, they have been tested mainly for industrialized countries and for a number of developing countries. To our knowledge, only selected aspects of recent central bank legislation have been analyzed for a limited number of Central and Eastern European transition economies up to now: Eijffinger and Van Keulen (1995), for instance, include the new central bank legislation of the Czech Republic, Hungary and Poland in their survey of eleven countries.[27]) Moreover, Siklos (1994) constructed an index of legal CBI for the Czech Republic, Hungary, Poland and Slovakia and compared these indices to the inflation performance of these countries. Hochreiter et al. (1996) examine the creation and distribution of seignorage in the Czech Republic, Hungary and Romania in the year 1993, taking Austria and Germany as a benchmark.[28]) A brief overview of the central bank legislation in selected transition economies can be found in Hochreiter (1994) and Hochreiter and Riesinger (1995).[29])

Whereas the empirical literature provides evidence that there is a negative correlation between legal CBI and inflation as well as between legal CBI and inflation variability in industrialized countries, this correlation does not hold for developing countries. However, if a proxy for actual CBI, such as the turnover rate of governors (defined as the average term of office of central bank governors), is used to measure the degree of CBI, a strong positive association between inflation and CBI can be found for developing countries.[30]) However, it has to be noted that this correlation does not say anything about causality. As regards the relationship between CBI and real economic aggregates, such as real GNP growth, output variability, the level of unemployment and the like, no clear correlation has been found either for industrialized or for developing countries.[31]) In the existing empirical literature, the relationship between CBI and inflation performance has not yet been examined for the Central and Eastern European transition economies. Nor will we attempt to analyze this relationship for the CEEC-5, because the track record of the CEEC-5 since the beginning of the transformation process is far too short to produce robust statistical correlations, as the time series available cover a maximum of seven years or even less (Czech Republic, Slovakia, Slovenia). The potential contribution of CBI to disinflation can hardly be quantified, as inflation is a very complex phenomenon, in particular in countries facing a regime shift. We doubt that the degree of CBI is the major factor explaining inflation performance in the CEEC-5. In an environment of economic transformation and stabilization programs, the inflation path is typically determined by a number of factors which are not directly influenced by the central bank: Other factors not under central bank control, like price liberalization, tax reform or widespread indexation, mainly determine the level and the variability of inflation during transition[32]) and are more predominant than the status of the central bank.

3 Reasons for Establishing Independent Central Banks in Transition Economies

Most countries in transition endowed their newly created central banks with a relatively high degree of legal independence already at the beginning of the reforms and are strengthening CBI further.[33]) One reason for establishing an independent central bank from the outset can be seen in the general effort to create a "Western" institutional framework comparable to that of market economies.[34]) Since the conclusion of EU Association Agreements and the official application for EU membership by a number of transition countries, this argument has taken on a much more practical dimension: The fulfillment of the institutional requirements of the Maastricht Treaty, and thus CBI, constitutes one of the conditions for joining the EU. According to Article 108 of the Treaty, all Member States have to make their national legislation regarding CBI compatible "at the latest at the date of the establishment of the European System of Central Banks (ESCB)."[35])[36])

Another motivation for CBI lies in its alleged success. The impressive track record of the German Bundesbank in terms of inflation performance over the last decades has demonstrated that a high degree of legal CBI sends the desired signal to politicians and economic agents and thus functions as an effective device to achieve long-term price stability. Therefore, the newly created central bank laws in the transition countries, which were often drafted with the assistance of international organizations (e.g. IMF, BIS) or of Western central banks, strongly mirror existing Western central bank laws, in particular the one on the Deutsche Bundesbank.

One of the specific reasons for establishing independent central banks was the adoption of drastic stabilization programs in a number of the transition countries analyzed, which aimed at bringing down inflation from initially very high levels. Therefore, a high degree of credibility of anti-inflation policies and hence of central bank credibility was needed from the outset of the reforms, first to successfully conduct a nonaccommodative monetary policy and later on to safeguard the results after successful stabilization. The adoption of legal provisions fostering CBI was certainly an important step to underpin central bank credibility, as a credible commitment of an autonomous central bank to price stability enhanced the confidence of the public in the stabilization policy. In our view, building up this "credibility bonus" for the new central bank had two dimensions: First, monetary policy credibility and its perception by the public was of enormous importance for the political and economic stability *within* the country. Second, credible central bank policies strengthened the confidence of *international* financial markets in the domestic market, which was particularly important for a number of transition countries that were in need of funds from abroad.[37]) In this context, it was extremely important to break with the ancien regime and to protect monetary policy authorities by law from political interference, thus sending the right signals to potential foreign investors as well as to domestic economic agents. However, the "credibility bonus" did not automatically result from a high degree of legal independence, but had to be earned repeatedly in practice. In this context the degree of actual independence of the central bank and its perception by the public (both at home and abroad) are of crucial importance.

We argue that the relatively high degree of legal central bank independence in Central and Eastern Europe helped to build up the necessary credibility of monetary policy in a period of economic transformation and stabilization. However, a number of factors contributing to inflation in these countries were not mainly determined by the central bank and the degree of its legal independence. The recent strengthening of legal CBI in the CEEC-5 can be seen rather as part of the overall reform of the institutional framework in these countries and as an effort to fulfill the institutional requirements of the Maastricht Treaty in view of future EU membership. Notwithstanding legislated CBI, the actual implementation of the central bank laws still shows some weaknesses.

In the following two sections, we will first go into several aspects of legal CBI in the CEEC-5, in particular against the backdrop of the requirements of the Maastricht Treaty ("benchmark").[38]) We will then discuss how legal provisions are implemented in practice and what impact this implementation has on the overall credibility of the examined central banks. Throughout the paper, we will address the question of independence from whom and for what purpose.[39])

4 Legal Independence

We will base our analysis of legal CBI in the CEEC-5 upon the four-tier classification derived from the text of the Maastricht Treaty, a classification of CBI criteria which was first presented by the Bank of Japan and later modified by Bruni[40]): (1) principal statutory objective; (2) independence in the formulation of monetary policy; (3) prohibition of credit facilities to the public sector; and (4) status of the governor. For the purpose of examining additional aspects of legal CBI which might be of particular relevance for transition economies, we have broadened this classification in the following manner: Item (2) is extended to cover the formulation and implementation of monetary policy (including the choice of instruments and related issues). Moreover, item (3) is extended to what we will refer to as "financial independence" and will cover two aspects, namely limits to government lending as well as the issue of budgetary independence of the central bank. Under item (4), which we will call "personal independence," we will examine the role and status of top central bank officials, including the managing board as well as the central bank governor. Furthermore, we have expanded this four-tier classification to include one additional aspect of legal CBI, namely accountability.[41]) Thus, our classification covers all criteria contained in the standard distinction of "institutional," "personal," "functional" and "financial" independence as well as some additional aspects that we consider relevant for the analysis of the CEEC-5.

An explicit reference to the "independent" status of the central bank in the wording of the central bank law (statutory independence) is generally not seen as a necessary condition to achieve a high degree of legal CBI and is therefore not included in our classification system. However, it is interesting to note that – with the exception of Poland – all central bank laws in the CEEC-5 contain such a stipulation. The central bank acts of the Czech Republic, Slovakia and Slovenia contain very similar clauses endowing the

central banks with independence to fulfill their tasks as defined by the primary objective of monetary policy.[42]) The Hungarian central bank act gives the central bank independence "within the framework of this Act."[43]) In Slovenia, the independence of the central bank is even postulated in the constitution (see below).

4.1 Principal Statutory Objectives

There is a general consensus in the literature that independent central banks tend to have a single, rather narrowly defined policy objective, the focus of which lies primarily on the stability of the domestic and sometimes also the external value of the national currency.[44]) One reason a single policy goal could be preferable to multiple goals is the need for transparency and credibility of monetary policy. In the presence of a range of – sometimes even conflicting – macroeconomic goals, the public could perceive the risk of policy shifts, which could jeopardize the credibility of monetary policy. However, having a single policy goal does not mean that the central bank can ignore other macroeconomic goals, but that it should have a clearly defined primary objective. Therefore, a number of central bank laws (such as that of Austria or Germany) as well as the ESCB and ECB Statute[45]) require the central bank to support the general economic policies. Price stability is generally regarded as a more desirable primary objective for a central bank than economic growth or full employment, because it can be influenced – though via a complicated transmission mechanism – by the central bank through the use of monetary instruments. The distinction between the internal and external purchasing power of the domestic currency, which is sometimes encountered in the formulation of monetary policy goals, could be a source of conflict in the conduct of monetary policy depending on the chosen exchange rate regime.[46])

According to Article 105 (1) of the Maastricht Treaty and Article 2 of the Statute, the core element of the future ESCB will be the objective of maintaining price stability. This stipulation will provide the operational framework for all participating national central banks (NCBs) from the beginning of Stage Three[47]) and will therefore be binding for the central bank legislation in the EU Member States as well as for membership applicants at the time of their EU entry.

In the CEEC-5, most central banks have a narrowly defined, primary policy objective which mainly focuses on the stability of the currency (see Table 1).[48]) The Hungarian central bank act mentions both the external and internal stability of the national currency. Although the text of the Slovene central bank law stipulates two primary objectives, namely a stable national currency and the general liquidity of the payment system, the central bank interprets price stability as its ultimate goal of monetary policy.[49]) The formulation of the Polish central bank law in this respect is rather vague, calling for "strengthening the Polish currency," which is seen by the central bank as a requirement to enhance the stability of the national currency. The term "currency stability" is generally interpreted as implying the objective of price stability, and in this sense most central bank laws are in line with the Maastricht requirements. However, it is argued in the strictest sense[50]) that

Table 1

Statutory Objectives of Central Banks and Formulation of Monetary Policy in the CEEC-5

Legal basis	Statutory objective	Formulation and implementation of monetary policy	Coordination with the government
Czech Republic Act on the Czech National Bank, 1992	"… to ensure the stability of the national currency …" (Art. 2)	• "The Bank shall set monetary policy …" (Art. 2a) • The Bank Board "shall set the instruments for implementation" (Art. 5.1) • The Bank "proclaims the exchange rate …" (Art. 35a)	• A member of Government may attend Bank Board deliberations in an advisory capacity (Art. 9.2) • The Bank shall act in an advisory capacity to the Government (Art. 10.2) • The Governor is entitled to attend meetings of the Government in an advisory capacity (Art. 11)
Hungary Act on the National Bank of Hungary, 1991, as most recently amended in 1996	"… to safeguard domestic and external purchasing power of the national currency …" (Art. 4.1)	• The Bank "… develops its monetary policy as well as the instruments serving its implementation …" (Art. 6) • The exchange rate regime "… is approved by the Government in agreement with the Bank …" (Art. 13.2)	• The Bank "… supports the economic policy programme of the Govern-ment …" (Art. 3) • The Bank participates in "… the elaboration of the economic policy programme of the Government …" (Art. 42) • The Bank and the Finance Ministry mutually reconcile their intentions on annual guidelines for monetary policy, budgetary estimates and financing of budget deficit" (Art. 43)
Poland Act of the National Bank of Poland, 1989, as most recently amended in 1996	"…strengthening the Polish currency…" (Art. 5.1)	• The Bank "initiates directions and forms the monetary policy… according to the recommendations of Parliament" (Art. 6.2.2) • Exchange rate regime determined by Council of Ministers on proposal of Bank President in consultation with the Finance Ministry and Ministry of Economic Cooperation (Art. 39.1)	• The Bank "cooperates in the realization of the economic policy of the State …" (Art. 5.2, Art. 6.2.1) • The Bank gives an opinion on the budget act (Art. 16.2) • Monetary policy guidelines are passed by Parliament together with the budget act. (Art. 17.2) • NBP President participates in sessions of Parliament and the Council of Ministers (Art. 50)
Slovakia The National Bank of Slovakia Act, 1992	"… ensure the stability of the Slovak currency …" (Sect. 2)	• "The Bank shall define monetary policy …" (Sect. 2.a) • "… the Bank Board shall … set the instruments … and determine specific monetary policy measures …" (Sect. 6.1) • The Bank shall "establish the exchange rate…" (Sect. 28a)	• The Bank "shall support the economic policy of the Government …" (Sect. 12.1) • Bank Board meetings may be attended by a Government member in an advisory role (Sect. 12.3) • The Bank shall "serve in an advisory capacity" (Sect. 13.2) • The Governor shall "participate in meetings of the Government" (Sect. 13.3)
Slovenia The Law on the Bank of Slovenia, 1991	"… stability of the domestic currency and general liquidity in payments …" (Art. 2)	• "The Governing Board of the Bank … shall determine the monetary policy …" (Art. 20) • "The Governing Board of the Bank … shall adopt measures for the implementation …" (Art. 20)	• The Bank may "… give incentives for laws and other regulations in the areas of monetary and foreign exchange systems …" (Art. 3)

this wording does not unambiguously reflect the primacy of maintaining price stability. In any case, a reformulation of the primary goal of monetary policy in the Polish law should be considered in order to bring legislation in line with the Maastricht standards.

4.2 Independence in the Formulation and Implementation of Monetary Policy

It is widely acknowledged in the literature that an efficient conduct of monetary policy should be coordinated in some way with the economic policies pursued by the government, while the legal provisions for cooperation mechanisms in this realm might differ from country to country. In this section, we will first deal with the formulation of monetary policy, and then with its implementation.

According to Article 105 (2) of the Maastricht Treaty and Article 3.1 of the Statute, the basic task to be carried out through the ESCB is the definition and implementation of monetary policy of the Community. The Treaty and the Statute also contain regulations that provide for a certain degree of cooperation between the ESCB and the Community, requiring the ESCB to "… support the general economic policies in the Community …" (Article 105 of the Treaty and Article 2 of the Statute), as long as this does not affect the primary goal of price stability.[51]) At the same time, the independent status of the ECB and the NCBs (being integral parts of the ESCB) is protected by the stipulations laid down in Article 107 of the Treaty, reproduced in Article 7 of the Statute: These provisions prohibit the ECB, the NCBs and members of their decision-making bodies "to seek or take instructions from Community institutions or bodies, from any government of a Member State or from any other body." Vice versa, it is also forbidden for Community institutions or bodies or any other external source of influence (e.g. governments, parliaments) to actively try to influence decision-making bodies in the ECB or NCBs. The EMI interprets these regulations as follows: The right of third parties to give instructions to the NCBs as well as the right to approve, suspend, annul or defer their decisions are incompatible with the Treaty and the Statute. According to the EMI, a right to censor NCB decisions on legal grounds is also incompatible with the Treaty and the Statute. The participation of third party representatives in decision-making bodies of the NCBs is regarded as unacceptable, if this representative has a voting right. However, a mutual consultation between the NCBs and government/parliament bodies is broadly regarded as being compatible with the Treaty and the Statute in order to assure a certain political dialogue between monetary and political authorities.[52])[53])

The formal responsibility to design monetary policy is exclusively given to the central banks in all of the CEEC-5 with the exception of Poland, where the central bank has to design monetary policy together with Parliament (see below). As regards decisions concerning the choice of the exchange rate regime, the Czech National Bank, the Bank of Slovakia and the Bank of Slovenia are formally responsible for setting the exchange rate, though important changes are in practice discussed with the government. In Hungary and Poland, the law stipulates that this question be resolved jointly with the government (see Table 1).[54]) A certain degree of overall policy coordination is required by the laws of the central banks in Hungary, Poland and the Slovak Republic, which have to "support the economic policy of the government." In this context it seems important whether the law directly links the requirement to support the economic policy of the government

with the principal statutory goal. The Czech and the Slovak central bank laws both provide a framework for mutual cooperation between the central bank and the government, where the participation of a government representative "in an advisory capacity" in Bank Board meetings as well as the participation of the central bank governor in government meetings are provided for by law. The Hungarian central bank law also contains provisions for cooperation between the central bank and the government, but with a less clearly defined operational framework. For instance, the government is represented at the sessions of the bank's Board of Directors by a minister[55]) – the law does not state explicitly whether this is only in an advisory capacity. Moreover, the Hungarian legislation goes one step further and entitles the Bank to participate in the preparation of the economic policy program of the government. Depending on how strictly the Treaty and the Statute are interpreted, the wording of Article 43 in the Hungarian central bank act could be an issue for discussion, if the "mutual reconciliation of intentions" between the bank and the Ministry of Finance is understood as an obligation for the central bank to consult political authorities. The Polish legislation determines very strong coordination mechanisms: The central bank has to submit the monetary policy guidelines for the following year to Parliament, where they have to be passed simultaneously with the budget act presented by the government. The National Bank of Poland is endowed with a right to give an opinion on the project of the budget act prior to its presentation. While the Polish legislation might have been intended to bring about an optimal degree of coordination between monetary and fiscal policies, an adoption of monetary strategies by Parliament is not likely to be compatible with the requirements of Article 107 of the Maastricht Treaty.[56]) The Slovene central bank law does not contain any provisions for policy coordination. It is interesting to note that none of the central bank laws under consideration contains arrangements on the solution of potential conflicts between the central bank and government bodies.

It is widely recommended that a central bank be given the right to design monetary policy instruments and be allowed to use them autonomously, thus enjoying "instrument independence" as defined by S. Fischer[57]). According to Article 105 (2) of the Maastricht Treaty as reproduced in Article 3.1 of the Statute, the ESCB has the responsibility "... to define and implement the monetary policy of the Community." Furthermore, Article 12.1 of the Statute stipulates that the Governing Council, which is the highest decision-making body of the ESCB, comprising the members of the Executive Board of the ECB and the Governors of the participating NCBs, "shall formulate the monetary policy of the Community, including, as appropriate, decisions relating to intermediate monetary objectives, key interest rates and the supply of reserves in the ESCB, and shall establish the necessary guidelines for their implementation." The Executive Board of the ECB implements monetary policy in accordance with the abovementioned guidelines and decisions. While open market and credit operations as well as minimum reserves are explicitly mentioned as possible monetary policy instruments to be used by the ECB (Articles 18 and 19 of the Statute, respectively), it is interesting to note that the Governing Council may, by a majority of two

thirds, decide on the use of other monetary policy instruments (Article 20 of the Statute).[58]) This regulation endows the ECB with full instrument independence in S. Fischer's sense.

All central bank laws in the CEEC-5 – save the Polish law[59]) – explicitly state the central bank's formal competence to determine the instruments necessary for the implementation of monetary policy (see Table 1). In an environment of low budget deficits or even budget surpluses, it is of particular importance that the central bank has the right to issue securities in order to prevent any dependence on the government's issuing policy in this respect.[60]) While the central banks of the Czech Republic, Poland, Slovenia and Slovakia are expressly endowed with this right[61]), it is interesting to note that the Hungarian legislation lacks an explicit provision in this realm. In practice, the Bank of Slovenia and the Czech National Bank have been issuing their own securities since the beginning of their operation, the National Bank of Poland reestablished the issue of own bills in 1994, and the National Bank of Slovakia for the first time issued its own bills in 1995. However, in practice the choice of instruments is somewhat limited by a number of factors. First, especially in transition countries the lack of well-developed financial markets may have necessitated the use of direct credit controls at least at the beginning of the transformation process before functioning money markets and money market instruments could be put in place. Second, the choice of the exchange rate regime – a decision which in most cases has to be taken jointly with the government (see above) – has a considerable impact on the degree of independence in the use of monetary policy instruments[62]): The adoption of a fixed exchange rate regime (with a small or without a fluctuation band around the central parity) prevents the central bank from actively using the exchange rate as an instrument of monetary policy. Depending on how tightly specified the constraints of creating credit are, instrument independence can be more or less restrained under such an arrangement.[63]) In countries where the pegged exchange rate has a wider fluctuation band (e.g. the Czech Republic), the width of the band determines the room for autonomous action of the central bank.[64])

4.3 Financial Independence

The term "financial independence"[65]) of the central bank covers the following two aspects in this paper:

- budgetary independence of the central bank itself – in other words: Does the central bank have the appropriate financial means to fulfill its tasks independently of government bodies? and the
- prohibition of direct credit facilities to the public sector.

For the budgetary independence of the central bank, it is of crucial importance whether the bank is entitled to determine its expenses and revenues autonomously or whether the approval of a government body is required. It is widely acknowledged that the central bank should not be financially dependent on the state budget; financial dependence would potentially put political bodies in a position to exert some influence on monetary policy decisions. Another important gauge of financial independence is the use and allocation of profits, which can be subject to a

decision of the central bank's organs, can be prescribed in detail by the central bank law or, theoretically, be subject to decision by the government or government-related institutions. Typically, the central bank laws stipulate that a major part of central bank profits be transferred to the state budget. Another very important issue is the coverage of potential central bank losses: The stipulation of automatic coverage of central bank losses by the state budget in the central bank law is generally regarded as a further guarantee for CBI.[66]) The approach of transferring central bank profits to the state budget and, at the same time, covering potential losses from the state budget can be seen against the following background: It is argued that profits or losses of the central bank are due to factors which have only little to do with the efficient management of the central bank as an "enterprise"; much rather, they are due to other factors determined by monetary policy strategies (e.g. the interest rate level). Therefore, a central bank's performance can only be assessed on the achievement of monetary policy objectives and not on the basis of the profit and loss account. The EMI's position on budgetary independence of central banks goes in the same direction: An ex-ante influence of third parties on a central bank's budget and/or profit distribution may jeopardize its independence, unless there is a safeguard clause in the law that guarantees the proper fulfillment of the central bank's tasks.[67])

In the CEEC-5, the responsibility to determine the central banks' budget is generally assigned to the banks' managing boards, while in Hungary the General Meeting has the ultimate say on the allocation of profits (see Table 2). The typical pattern for the use and distribution of central bank profits prescribed by all central bank laws examined is as follows: First, part of the profit is allocated to funds, which mainly aim at replenishing the bank's reserves in order to provide a cushion for potential future losses and, in addition, cover a range of other predefined purposes. Second, the profit remaining after deductions for allocations to funds is typically transferred to the state budget. The legislation in the CEEC-5 is more differentiated on the issue of the coverage of potential losses incurred by the central banks: According to the Polish and the Slovene central bank legislation, the losses have to be covered primarily by the resources from the abovementioned funds; only the Slovene law regulates the coverage of losses exceeding the funds. The Hungarian central bank law stipulates monthly transfers from the state budget in the case of central bank losses. Interestingly enough, the Czech and Slovak central bank laws do not contain any provisions in this area.

A crucial aspect of financial CBI is the legal restriction of central bank credits to the government: The central bank should not be impeded in fulfilling its stability mandate by having to meet the government's financial demands of extending direct loans (or simply printing money) to cover the state deficit. There is a general consensus on the legal prohibition of direct central bank credit to the government, be it in securitized or nonsecuritized form (e.g. advances or purchases of government papers on the primary market, overdraft facilities). Indirect central bank credit – the acquisition of government securities by the central bank on the secondary market – is permitted by a number of Western central bank laws.[68]) However, most of

Table 2

Financial Independence of Central Banks in the CEEC-5

Limits to government lending		Budgetary independence		
Direct credit	Indirect credit	Ownership; management of budget	Allocation of profit	Coverage of potential losses
Czech Republic				
• Purchase of short-term (3 month) Treasury bills permitted • Maximum: 5% of previous year's state budget revenues (Art. 30.2)	• In order to regulate the money market the Bank can buy and sell negotiable securities (Art. 32)	• Bank budget approved by the Bank Board (Art. 47.1)	• Profits are to be used to replenish reserves • Remaining portion transferred to the state budget (Art. 47.2)	No provision
Hungary				
• Short-term liquidity loans to bridge temporary difficulties permitted (Art. 19) • Maximum: 2% of planned budget revenues	• The Bank enters into security transactions with repurchase agreements (Art. 9c)	• Joint stock company owned by the state (Art. 54)	• Upon decision of the General Meeting (Art. 56) • Monthly transfers of profits to the state budget (Art. 78.4)	• Monthly transfers from state budget to cover losses (Art. 78.4)
Poland				
• Purchase of government securities on the primary market permitted • Maximum: 2% of the planned state budget expenditures (Art.34)	No provisions concerning the secondary market	• Bank's own finances managed in accordance with economic policy guidelines adopted by the Sejm (Art. 73.1) • Board of Management determines financial plan for each year (Art. 73.2)	• Profits allocated to statutory fund, reserve fund and special funds (Art. 69–72) • After deductions for funds part of the profit is transferred to the state budget (Art. 77)	• Losses to be covered by reserve fund (Art. 70) • No provisions for losses exceeding reserve fund
Slovakia				
• Purchase of short-term (3 month) Treasury bills to cover fluctuations in the state budget permitted • Maximum: 5% of state budget revenue of previous year (Sect. 25.2)	• Bank may purchase and sell negotiable securities for the purpose of regulating the money market (Art. 27)	• Bank budget approved by the Bank Board (Sect. 38.1)	• Profits used to replenish the level of reserves and other funds • Remaining profits transferred to state budget (Sect. 38.2)	No provisions
Slovenia				
• Short-term loans to bridge temporary imbalances in the budget permitted (Art. 61) • Maximum: 5% of budget of current year and not more than 1/5 of anticipated budget deficit (Art. 61)	• "The Bank shall regulate the amount of money … by purchasing and selling state securities" (Art. 25.2)	• Financial Plan adopted by the Governing Board of the Bank and subject to approval of Parliament (Art. 82)	• Profits may be allocated to fixed assets and special reserve fund (Art. 78) • Profits after these allocations are transferred to budget (Art. 83)	• Losses are to be covered by special reserve fund (Art. 83) • If losses exceed special reserve fund, the rest has to be covered by the budget (Art. 83)

these laws contain safeguard clauses which limit this kind of transaction to operations conducted for monetary policy purposes. The main explanation for the absolute prohibition of direct central bank lending to the government is that the full and exclusive control of the monetary base has to be located at the central bank, thus excluding the government from any influence on the growth of the monetary base. The rationale behind the permission of indirect central bank lending to the government is that on the secondary market, government papers are traded at market rates, thus making public and private sources of funding close substitutes. According to Article 104 (1) of the Maastricht Treaty, "overdraft facilities 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 ... shall be prohibited, as shall the purchase directly from them by the ECB or NCBs of debt instruments." Thus, the Maastricht Treaty explicitly prohibits only direct central bank credit to the public sector. As far as outstanding debt is concerned, the dates for the eventual amortization of the debt stock will have to be set. The practice in incumbent EU states is to find very long-term solutions to the repayment of such debt.[69])

In all five central bank laws under consideration, direct central bank lending to the government is still permitted, though to a differing degree, which is definitely not in line with the Maastricht requirements. However, the nature, maturity and maximum amount of these credits are precisely defined in the laws, which of course provides a certain safeguard clause for CBI. The most frequently encountered form of direct central bank credit to the government in the CEEC-5 is the purchase by the central bank of Treasury bills from the government on the primary market, as stipulated in the Czech Republic, Poland and the Slovak Republic. According to the Czech and the Slovak legislation, the maturity of these Treasury bills is limited to three months. The constraints on the maximum amount of these transactions are stipulated differently: While the Czech and the Slovak laws define the limit as a percentage of the previous year's budget revenues, the Polish central bank law[70]) imposes a percentage of planned state budget expenditures for the current year and does not specify the maturity (see Table 2). The Slovene legislation takes a different approach and provides for short-term central bank loans to the government which are exclusively devoted to the purpose of bridging temporary imbalances in the state budget. The maximum amount of these loans is defined as a percentage of the general budget deficit and, in parallel, of the budget expenses in the current year. The most recent amendment of the Hungarian central bank law (1997) mainly focuses on a redefinition of the relationship between the budget and the central bank: Similarly to the Slovene legislation, as of 1997 there remains only one exception to the prohibition of budgetary financing by the central bank, namely the granting of liquidity loans to the central budget for bridging short-term liquidity difficulties. The maximum amount of such financing is limited to 2% of planned budget revenues; the maturity may be up to 15 consecutive or separate days of a calendar month, and it has to be cleared by year-end. In addition, the amendment – in conjunction with the 1997 Budget Act – did away with a specific obligation of the Hungarian central bank to grant loans beyond the abovementioned limits in order to cover exchange rate losses resulting from the country's foreign borrowing activities. The new regulation shifted not only potential future, but also past losses resulting from foreign borrowing from the central bank's balance sheet to the state budget.[71])

4.4 Personal Independence

One of the cornerstones of legal CBI is personal independence, which is to guarantee that central bankers are in a position to fulfill their legal obligations. Of particular relevance are the arrangements concerning the role, status and composition of the Bank's important decision-making

bodies, including the appointment procedures, rules for dismissal, the length of the term of office, requirements for professional competence and incompatibility clauses. It is widely agreed that limiting the political influence on the procedure of appointing top central bank officials increases the degree of personal independence of the newly appointed central banker. In this respect legislation provides for different procedures: Either the state president or the government have the right to appoint a candidate, or the decision has to be taken by the parliament, thus including the opposition parties in the decision-making process. Moreover, the reasons for dismissal of the top officials have to be limited to transparent, exceptional circumstances and have to be clearly defined by law. A related question is the possibility of reappointing central bank officials, which is generally seen as nonsupportive to independent behavior.[72]) It is widely agreed that the legislated term of office of central bank top officials has to be clearly longer than the electoral cycle, which in most countries means more than four to five years.[73]) Moreover, it is sometimes argued that the central bank law should contain requirements concerning the professional qualifications of the top officials. Finally, incompatibility clauses for the top central bank managers are recommended in order to prevent potential conflicts of interest. These generally acknowledged requirements concerning the role and status of the top officials are also reflected in the construction of different models to measure legal CBI.[74])

In the Statute, most of the abovementioned requirements concerning the personal independence of the central bank are taken into account: The term of office for the top officials of the future ECB (members of the Executive Board) is set at eight years, and no reappointment is possible (Article 11.2 of the Statute). Moreover, the minimum term of office for Governors of NCBs is established as five years (Article 14.2 of the Statute), but of course their term may be longer. The Statute stipulates the following appointment procedure for the ECB top officials: They are appointed "by common accord of the governments of Member States ... on recommendation from the Council after it has consulted the European Parliament and the Governing Council" (Article 11.2 of the Statute). The required professional qualifications of ECB top officials are that they have to be "persons of recognized standing and professional experience in monetary or banking matters" (Article 11.2 of the Statute). Furthermore, the reasons for dismissal of both the ECB top officials and NCB Governors are restricted to the following two predefined cases: first, either the conditions for the performance of their duties are no longer fulfilled or, second, they are guilty of serious misconduct (Articles 11.4 and 14.2 of the Statute, respectively). This means that they cannot be dismissed on the grounds of their monetary policy decisions. The EMI is of the opinion that the provisions for the security of tenure of office should also apply to other members of the decision-making bodies of NCBs. The EMI argues that this demand can be justified by the wording of Article 107 of the Maastricht Treaty, which refers to "any member of decision-making bodies" rather than only to "Governors." Moreover, the EMI calls for incompatibility clauses for members of decision-making bodies which are not explicitly stipulated in the Maastricht Treaty.[75]) However, the Statute

Table 3

Personal Independence of Central Banks in the CEEC-5

Governor			Highest decision-making body			Incompatibility clauses
Term of office	Appointment	Dismissal	Composition; term of office of its members	Appointment	Dismissal	
Czech Republic 6 years (Art. 6.4)	Appointed by President of Republic (Art. 6.2)	• Criminal act • Inability to perform functions, based on Bank Board decision • Own request (Art. 6.6)	• Bank Board (BB): 7 members, Governor and 2 Vice Governors, 4 senior CNB officers (Art. 6.1) • Term: 6 years (Art. 6.4)	• Vice Governors appointed by President of Republic (Art. 6.2) • Senior CNB officers appointed by President of Republic (Art. 6.3)	• Criminal act • Inability to perform function, based on Bank Board decision • Own request (Art. 6.6)	BB membership incompatible with (Art. 6.5): • Membership in Parliament • Position in government • Top position in banks or enterprises
Hungary 6 years (Art. 58.2)	Appointed by State President on proposal of Prime Minister (Art. 58.2)	• Own resignation (Art. 58.5b) • Inability to perform functions (Art. 58.7a) • Conviction of a crime (Art. 58.7b)	• Central Bank Council (CBC): Governor, Deputy Governors, non-bank members (1 more than number of Deputy Governors) • Term of Deputy Governors: 6 years (Art. 59.2) • Further members: 3 years (Art. 59.3c)	• Deputy Governors appointed by State president on proposal of MNB Governor (Art. 59.1) • nonbank CBC members appointed by State president on proposal of Prime Minister, who has to consult with MNB Governor (Art. 57.3c)	• For Deputy Governors: see provisions for President (Art. 59.3) • No provisions for nonbank CBC members	• CBC members may not be party officials (Art. 69) • No ownership in or employment by or manage-ment of commercial bank (Art. 70)
Poland 6 years (Art.49.2), 2 consecutive terms possible (Art. 49.3)	Appointed by Parliament on proposal of State President (Art. 49.1)	• Own resignation • Inability to perform functions for more than 3 months due to illness • Criminal act • Tribunal's announcement disqualifying him (Art. 49.4) • Parliament's resolution on constitutional prosecution of president (Art. 49.5)	• Board of Management: President, Deputy Presidents and members of the Board (Art. 51.1) • No provisions for term of office	• Deputy presidents appointed by State President on proposal of NBP President (Art. 49.6) • Other Board members appointed by NBP president (Art. 49.6)	• Deputy Presidents dismissed by State President on proposal of NBP President (Art. 49.6); no reasons defined • Other Board members dismissed by NBP President (Art. 49.6), no reasons defined	No incompatibilty clauses
Slovakia 6 years (Sect. 7.4), 2 consecutive terms possible (Sect. 7.5)	Appointed by President of Republic on recommendation of government with consent of Parliament (Sect. 7.2)	• Criminal act • Inability to perform function, based on Bank Board decision (Sect. 7.8) • Noncompliance with Sect. 7.6 • Voluntary resignation (Sect. 7.7)	• Bank Board (BB): Governor, 2 Vice Governors, 2 executive directors, 3 other members (Sect. 7.1) • Term of Vice Governors and executive directors: 6 years (Sect. 7.4) • Other members: 4 years (Sect. 7.4)	• Vice Governors appointed by President of Republic on recommendation of Government with consent of Parliament (Sect. 7.2) • Executive directors and other 3 members appointed by Government on recommendation of Governor (Sect.7.3)	• Criminal act • Inability to perform function, based on Bank Board decision (Sect.7.8) • Noncompliance with Sect.7.6 • Voluntary resignation (Sect.7.7)	BB membership incompatible with (Sect.7.6): • Position as Member of Parliament • Position in government • Top position in banks or enterprises
Slovenia 6 years (Art.14), reappointment possible	Appointed by Parliament on proposal of State President (Art.14)	No provision	• Governing Board: 11 members; Governor, Deputy Governor, 3 Vice Governors, 6 independent experts (Art.12) • Term of Deputy Governor and Vice Governors: 6 years (Art.15)	• 6 experts appointed by Parliament on proposal of State President (Art.13) • Deputy Governor and 3 Vice Governors appointed by Parliament on proposal of Governor (Art.15)	No provision	No incompatibility clauses except for experts (Art.13): • No BoS staff • No top position in organization supervised by central bank • No elected state officials

contains a provision requiring that the members of the ECB Executive Board are to be full-time central bankers; any other occupation is prohibited "unless exemption is exceptionally granted by the Governing Council" (see Article 11.1 of the Statute). The EMI derives the general principle that "… membership of a decision-making body involved in the performance of ESCB-related tasks is incompatible with the exercise of other functions which might create a conflict of interest."[76])

A common feature of all central bank laws in the CEEC-5 is that the term of office of the governor comes to six years, which is longer than the electoral cycle in all countries. In this respect all central bank laws fulfill the standards set by Maastricht legislation. The duration of the appointment of the members to the central banks' highest decision-making bodies is also stipulated at six years, except for the Bank Board of the National Bank of Slovakia and for the non-central bank members of the Central Bank Council of the National Bank of Hungary (See Table 3). In the Czech Republic, Hungary and Slovakia, the central bank governor is appointed by the state president, whereas in Poland and in Slovenia, the parliament has the final say in appointing the governor. It is interesting to note that the Hungarian central bank law contains a professional qualification profile for the central bank governor as well as for the members of the Central Bank Council.[77]) Once appointed, the central bank governor is typically involved in the appointment procedures for the other members of the highest decision-making body, while the degree and the form of his involvement are regulated differently across the CEEC-5. It must be stressed that the members of the highest decision-making body are not appointed by the government in any of the countries examined, with the exception of Slovakia (see Table 3). All central bank laws in the CEEC-5 except the Slovene law exactly define and enumerate reasons for the potential dismissal of the central bank's governor, which puts them broadly in line with the Maastricht Treaty. The reasons for dismissal of other members of the highest decision-making bodies are clearly defined in the central bank laws of the Czech Republic, Hungary and Slovakia, while no such provision can be found in the Slovene law, nor does the Polish law define any reasons.

Only three central bank laws, namely the Czech, the Hungarian and the Slovak legislation, contain incompatibility clauses for all members of the highest decision-making body (see Table 3). The incompatibility clauses contained in the Slovene law only refer to the independent experts represented in the Governing Board. To our knowledge, none of the central bank laws analyzed contains a general prohibition for members of the highest decision-making body to exercise other functions which might create a conflict of interest. Therefore, if the Maastricht legislation is strictly interpreted, it seems that there is a need for adaptation of the incompatibility clauses in the central bank laws.

4.5 Accountability and Transparency

There is widespread agreement in the literature that central banks, though endowed with a high degree of independence, have to be held accountable – in one way or another – for achieving the legislated goals of monetary policy.[78]) It is argued that mechanisms for the democratic accountability of the central bank have to be put in place in order to create incentives for an autonomous central bank to fulfill its goals and to explain its actions to the public. For this purpose, a sufficient degree of transparency of monetary policy is needed, which enables the public to monitor monetary policy performance. Transparency can be legally guaranteed through different forms: In a number of parliamentary democracies, the central bank is primarily responsible to the parliament. In such cases the laws frequently stipulate that the central bank governor regularly meets with parliamentary bodies and explains and justifies the bank's monetary policy actions.[79]) Another approach is that the central bank is held directly accountable to the public and that it has to meet reporting requirements through regular publications (monthly/quarterly/annual reports, financial statistics, inflation reports). An important element of accountability is a clear definition of the ultimate goal, for which the central bank is held accountable. Moreover, a publicly announced intermediate target of monetary policy chosen to fulfill this goal could enhance transparency.[80]) A number of countries pursue the strategy of monetary targeting, arguing that the central bank should be held accountable only for the monetary impulses to inflation, which it can control more directly than inflation developments.[81]) An alternative approach is direct inflation targeting, where more emphasis is put on transparency, because inflation forecasts are more widely understood than estimated monetary aggregates. Moreover, a formal inflation target is a direct reflection of the ultimate goal of price stability. As a third strategy, a number of countries have defined the exchange rate as intermediate target, pegging the exchange rate to the anchor currency of a low-inflation country.[82])

Maastricht legislation stipulates that the future ESCB will be held accountable to several European bodies as well as to the public at large. According to Article 109 b (3) of the Treaty, the ECB is obliged to submit an annual report on the activities of the ECSB and on the monetary policy of both the previous and current years to the European Parliament, the Council and the Commission, and also to the European Council. At the request of the European Parliament or on their own initiative, the ECB President and other members of the Executive Board can be invited to a hearing in the committees of the European Parliament. To fulfill the requirement of accountability towards the public, the ECB must, under Article 15.1 of the Statute, present quarterly (or more frequent) reports about the activities of the ESCB and must publish a weekly financial statement (Article 15.2). Moreover, the annual accounts of the ECB must be published (Article 26.2).

In the CEEC-5, the central banks are all accountable to parliament:[83]) While the Slovene legislation only contains a general notion that the activity of the central bank is supervised by Parliament, the central bank law stipulates no detailed reporting requirements. According to the Czech and the Slovak legislation, the central banks have to submit reports to Parliament

twice a year. Moreover, both laws contain regulations on the bank's general responsibility towards the public, requiring the bank to publish information about monetary developments at least every quarter.[84]) The Hungarian and the Polish central bank laws contain more comprehensive reporting requirements: In addition to an annual report to be submitted to Parliament, the National Bank of Hungary is obliged to furnish regular reports on monetary policy also to the government and ministries. In Poland, periodical reports on the implementation of the monetary policy guidelines have to be submitted not only to Parliament, but also to the Council of Ministers.[85]) Although reporting to the public is explicitly required only by the Czech and the Slovak legislation, in practice all five central banks publish monthly and annual reports. In addition, quarterlies on monetary policy developments are produced by the Czech National Bank, the National Bank of Slovakia and the Bank of Slovenia. However, the accountability of the CEEC-5 central banks to the national parliaments implies the potential danger of political influence on the central bank exerted by members of parliament, who may act as representatives of certain lobbies or interest groups,[86]) such as exporters asking for a devaluation of the domestic currency, entrepreneurs striving for lower interest rates on credits, etc.[87]) This danger, however, is very limited, because in most cases (except for Poland until the endorsement of the new constitution) the central bank only has to fulfill reporting requirements and is not obligated to follow any instructions given by parliament.

In sum, the CEEC-5 legislation on central bank accountability is broadly compatible with the requirements of the Maastricht Treaty.

5 Some Aspects of Actual Independence

Although the legal status of a central bank provides an important yardstick to assess CBI in a particular country, this is only one element determining the independence of the central bank, while the implementation of the central bank law in practice and the perception of CBI by the public – which is defined as the "reputation of independence" by Bruni[88]) – also play a very important role. Actual CBI may differ from legal CBI, as on the one hand, a number of factors reduce the degree of actual independence as compared to legal CBI, but on the other hand, there are also examples where actual CBI is higher than legal independence. As pointed out earlier, the "credibility bonus" of a central bank does not result automatically from a high degree of legal independence, but has to be earned and defended constantly in practice. Whereas laws and treaties provide the necessary legal framework, the most effective protection of CBI is a broad anti-inflationary consensus supported by policymakers and the public at large.

While we have applied the institutional requirements of the Maastricht Treaty and the Statute as a yardstick to assess legal CBI in the CEEC-5, we will analyze the degree of actual CBI by comparing the legal status of the central bank with the implementation of the law in practice, using indicators such as the turnover rate of governors, political vulnerability, overriding of the central bank law by budget laws, etc.

In most, if not all countries worldwide, CBI is potentially vulnerable, as the central bank law can be changed by a simple majority in parliament. This

implies that a government which relies on a majority of mandates in parliament could theoretically threaten to radically change the legal status of the bank. In this context, the frequency of political changes in parliament and the political readiness of the deputies to reduce CBI by changing the central bank law more or less frequently are very important determinants of central bank autonomy in practice. A case in point is Bulgaria, where Parliament passed (with a simple majority) a highly controversial amendment of the Central Bank Act in April 1996 which substantially modified the appointment procedures of the bank's top officials (see below). In order to preclude this potential danger for CBI, some experts even recommend that the central bank law should be written into the country's constitution or that a two-thirds majority of parliament should be required for any amendment of the central bank law.[89]) Interestingly, in most of the CEEC-5 the constitution contains some provisions on the central bank. Slovenia is the only country whose consitution explicitly states the independent status of the central bank. Moreover, the Slovene constitution determines the appointment procedure of the central bank Governor as well as the bank's accountability to Parliament. The Czech constitution defines the primary goal of the central bank as currency stability and contains appointment procedures for the members of the Bank Board. In Hungary, the constitution stipulates the main tasks of the central bank, the appointment procedure for the Governor and an annual reporting requirement to Parliament. The Slovak constitution only mentions the establishment of a central bank. An interesting case is the new draft constitution of Poland,[90]) which will entail, after its endorsement by referendum, fundamental changes in the central bank legislation. The draft constitution endows the central bank with the sole right to determine and implement monetary policy and to issue money. Moreover, it determines the bodies of the central bank, introduces a Monetary Policy Council, and stipulates appointment procedures, terms of office as well as incompatibility clauses for the Governor. In contrast to other countries analyzed, the Polish draft constitution explicitly prohibits the central bank from financing the state budget deficit.

Another threat to CBI may result from incomplete definitions or gaps in central bank laws and the way these imperfections of legislation are dealt with in practice. As Bruni[91]) pointed out, sufficiently strong political pressure applied to at least one of the gaps may considerably weaken the degree of legal independence of the central bank. Finally, the extent to which legal CBI is translated into actual CBI is also influenced by the degree of general adherence to the rule of law, which depends on a country's history and culture. Under the socialist regimes, the general respect of law – unless enforced by severe sanctions in case of noncompliance – was widely reduced or destroyed.[92]) Moreover, as the transition economies have been undergoing a fundamental building and/or restructuring of institutions, the magnitude of unanticipated shocks and hence the temptation to bend the law might have been higher than in normal times.[93]) For instance, in an environment of high budget deficits, there might be a particularly strong temptation to override the central bank law by allowing for some form of central bank financing to the public sector despite its prohibition or limitation in the central bank law (see below).

However, it is also possible that legally rather dependent central banks nevertheless enjoy a high degree of actual autonomy, for instance on the strength of their governor's personality: If the central bank governor is a highly reputable person in public life who openly resists any political pressures to change the monetary policy stance, he or she might in practice enjoy a high degree of credibility which goes far beyond the degree of legal independence granted to the central bank by law. In a similar vein, it is argued that the quality and the reputation of the central bank's staff is an important component of actual CBI.[94])

In the following section, we will discuss selected aspects of actual CBI to shed some light on how the credibility and reputation of central banks can be jeopardized despite a relatively high degree of legal CBI or how legal CBI can be strengthened in practice.

5.1 Turnover Rate of Governors and Political Vulnerability

Although a number of different models to measure legal CBI have been developed up to now (see section 2), it is very difficult to quantify the degree of actual independence. The most prominent approach in this area was taken by Cukierman,[95]) who introduced the turnover rate of governors as a proxy for actual CBI. The turnover rate of governors is defined as the average term of office of central bank governors in different countries, with this indicator being based on the assumption that a higher turnover rate indicates a lower degree of actual CBI and vice versa. Empirical evidence as presented by Cukierman shows that even if the legal term of office is longer than the electoral cycle, the actual term of office can be significantly shorter.

In the following, we have attempted to measure the turnover rate of governors for the CEEC-5 (see Table 4). As our reference period, we have

Table 4

Turnover Rate of Governors in the CEEC-5

Governors	Period of reference	Turnover rate of governors[1])
Czech Republic		
• **Josef Tošovský** since Feb. 17, 1993[2])	Dec.1992–March 1997	0.23
Hungary		
• **Péter Ákos Bod** Dec. 9, 1991–Dec. 14, 1994	Dec.1991–March 1997	0.38
• **György Surányi** since March 1, 1995		
Poland		
• **Zdzisław Pakuła** July 13, 1988–Sep. 11, 1989	Feb.1989–March 1997	0.49
• **Władysław Baka** Sep. 21, 1989–Jan. 24, 1991		
• **Grzegorz Wójtowicz** Jan. 25, 1991–Aug. 9, 1991		
• **Hanna Gronkiewicz-Waltz[3])** since March 5, 1992		
Slovakia		
• **Vladimír Masár** since Aug. 1, 1993[4])	Nov.1992–March 1997	0.23
Slovenia		
• **France Arhar** since June 25, 1991 reappointed on April 1, 1995, for another 6 years	June 1991–March 1997	0.17

[1]) *Calculated as the number of governors divided by the length (in years or fractions of years) of the reference period.*
[2]) *As the Czech National Bank was established later than the central bank law was promulgated, Tosovský's term starts later than our period of reference.*
[3]) *In the interim period: Deputy governor Andrzej Topiński Aug. 10, 1991–March 4, 1992.*
[4]) *Before: Vice Governor M. Tkác Jan. 1. 1993–July 29. 1993.*

chosen the date of the promulgation of the respective central bank law as a starting point for all countries, because the main purpose of this exercise is to examine the actual implementation of central bank legislation.[96]) In determining the number of governors appointed, we strictly counted only governors who were officially nominated and excluded from our calculation "acting governors" or "acting vice-governors" who just served during an interim period.

The turnover rate of central bank governors in the CEEC-5 during the reference period, however, has to be interpreted with caution for several reasons: First, the differences between the chosen periods of reference, depending on the promulgation date of central bank laws in the individual countries, crucially influence the calculated turnover rate: As the reference periods are generally very short (a maximum of eight years), a small change in the base period leads to substantial distortions in the outcome and therefore makes it extremely difficult to produce a cross-country comparison. Second, the reasons for a premature termination of the governor's term have to be carefully analyzed in every case before this step can be qualified as politically motivated: Did the governor resign voluntarily for solely personal reasons (e.g. health) or was there a fundamental political disagreement with the (new) ruling party? Was the governor forced to leave e.g. by an amendment of the central bank law? Was he dismissed?[97])

However, despite the abovementioned precautions, it might be interesting to take a closer look at the short history of central bank governors in the CEEC-5. Very low turnover rates of governors were measured in Slovenia, the Czech Republic and the Slovak Republic, with the reference period being shorter for the two latter, thus somewhat increasing their calculated turnover rate as compared to Slovenia. An interesting case in point is the Slovak Republic, where Governor Vladimír Masár was only appointed seven months after the establishment of the central bank in January 1993. Until his appointment the governor's duties were fulfilled by Vice-Governor Marián Tkác, who headed the National Bank of Slovakia as the Acting Governor until July 29, 1993. Hungary recorded a comparatively high turnover rate in the period under consideration: The first central bank governor during the reference period was Péter Ákos Bod, who was appointed in the same month the new central bank went into force. He followed György Surányi, who after one and a half years of tenure (July 1990 to December 1991) had been dismissed by the Prime Minister. This politically motivated step had been intensely debated.[98]) Péter Ákos Bod served only half of his six-year term until he resigned, as he had been increasingly in disagreement with the new coalition that came to power at the general elections in May 1994.[99]) As of March 1995, György Surányi returned to his former position, which could be seen against the background of a political change in Hungary: He was officially nominated central bank Governor at the same time Lajos Bokros was appointed new Finance Minister, and they both initiated the new stabilization package. The highest turnover rate was recorded in Poland: The first governor in the reference period, Zdzisław Pakuła resigned in September 1989 after the appointment of the new noncommunist, radical reformist government. Interestingly, the

first post-transition central bank Governor was Władysław Baka, who had been central bank governor already earlier (from 1985 to 1988) and who had been a member of the former ruling Communist Party Politburo. In January 1991, he handed in his resignation to President Lech Wałęsa, after a new government had been installed. He was succeeded by Grzegorz Wójtowicz, who served the shortest term in the CEEC-5 and who was dismissed as president of the National Bank of Poland in August 1991 for lack of supervision in a financial scandal, in which seven bankers, including Wójtowicz's first deputy, had been arrested for issuing unsecured credit guarantees.[100]) This scandal was followed by a difficult interim period of seven months, during which Vice-President Topiński was left to preside over the bank until a new central bank governor was appointed. During this interim period there were several attempts to agree on a new central bank governor: After Parliament had rejected the President's first candidate in August 1991, it also rejected Hanna Gronkiewicz-Waltz when she was first presented by Wałęsa as a candidate in December 1991, arguing that she lacked practical banking and management experience. It was only in March 1992 that Parliament finally approved Hanna Gronkiewicz-Waltz, after the President had nominated her again.

Although all central bank laws under consideration fulfill the Maastricht requirement of the governor's term of office exceeding the electoral cycle, the actual circumstances and number of appointments in some countries nevertheless substantially differ from the legislated tenures.

Table 5

Turnover Rate of Ministers of Finance in Hungary and Poland

Ministers of finance	Turnover rate of finance ministers
Hungary	
• **Mihály Kupa** Dec. 20, 1990–Feb. 12, 1993	0.94
• **Iván Szabó** Feb. 24, 1993–July 15, 1994	
• **Lázló Békesi** July 15, 1994–Feb. 28, 1995	
• **Lajos Bokros** March 1, 1995–Feb. 29, 1996	
• **Péter Medgessyi** since March 1, 1996	
Poland	
• **Andrzej Wróblewski** Oct. 14, 1988–Sep. 12, 1989	0.98
• **Leszek Balcerowicz** Sep. 12, 1989–Dec. 22, 1991	
• **Karol Lutkowski** Dec. 23, 1991–Feb. 27, 1992	
• **Andrzej Olechowski** Feb. 28, 1992–June 5, 1992	
• **Jerzy Osiatyński** July 1, 1992–Oct. 26, 1993	
• **Marek Borowski** Oct. 26, 1993–Feb. 8, 1994	
• **Grzegorz Kołodko** April 28, 1994–Feb. 4, 1997	
• **Marek Belka** since Feb. 4, 1997	

Another interesting concept in this context is related to the political vulnerability of the central bank governor, which is defined as the propensity of the governor to lose his position within a short period of time following a political change in the country.[101]) Defining this period of time as six months, Cukierman and Webb[102]) found strong evidence of political influence on central banks between 1950 and 1989 both in industrialized and in developing countries. We examined such a relationship between the changes of central bank governors in Hungary and Poland, where the turnover rate of governors was relatively high, and (preceding) changes in

the Ministries of Finance, which were used as a proxy for political change (see Table 5).[103]) However, according to the abovementioned definition of political vulnerability and using the same reference period as for calculating the turnover rate of governors, no clear pattern emerges, as the turnover rate of finance ministers is substantially higher than that of central bank governors in both countries. While changes of the central bank governor in a number of cases seem to have been politically motivated (see above), they were not necessarily an immediate consequence of a political change in the government.

5.2 The Importance of the Human Factor

As shown in the previous section, the relatively high degree of legal protection for central bank top officials in Central and Eastern Europe (length of tenure, detailed procedures of appointment and dismissal) does not entirely save them from political pressure in real life. The pressures faced by central bankers in the first years of economic transformation in Central and Eastern Europe were and still are considerable: While the governments typically push for faster growth, demanding low interest rates and a competitive exchange rate level to support the export economy, the central bank is held responsible for lowering inflation (in some cases from extremely high levels[104])). Therefore, the appointment of a conservative, "Rogoff-type" head of the central bank who is known for his or her strong preference for low inflation can enhance actual CBI even if the legal autonomy of the central bank is rather weak. Moreover, the personality of the central bank governor (and of his or her appointed deputies as well as of members of the highest decision-making body) is extremely important in order to strike the right balance between the necessary cooperation with the government and independence from it. A case in point is the Czech Republic, where cooperation has been the norm simply because Josef Tošovský the central bank Governor, is ready to bring monetary policy issues in line with fiscal policies through voluntary personal meetings with the Finance Minister and the Prime Minister.[105]) In September 1993, Tošovský was elected "Central Banker of the Year" on the occasion of the annual meeting of the International Monetary Fund and the World Bank in Washington. In Poland, the relationship between the government and the central bank looks completely different: Governor Hanna Gronkiewicz-Waltz, who was running an electoral campaign as a candidate for the presidential elections in 1996 while she was still in office as central bank governor, was widely known for being in constant political disagreement with Finance Minister Kołodko, and his predecessors, and for resisting pressures from the government to relax her monetary policy stance. However, in Poland, too, the government and the central bank have found compromise solutions, one example being the widening of the exchange rate band in May 1995.[106])

Another potentially important element of actual CBI is the quality of the bank's economic or research department and its reputation in comparison with research institutes in the country. It is argued that a central bank governor who can rely on a competent economic department providing him with the necessary argumentation can certainly more easily defend the

central bank's position in the case of disagreement e.g. with the minister of finance. The quality of the research or economic department is inter alia reflected by the quality of the bank's publications (annual/quarterly/ monthly reports, working or discussion papers and the like).[107]) Furthermore, in a number of countries the central bank performs the role of the government's main economic advisor, which considerably strengthens the central bank's reputation and public acknowledgment of its expertise. Moreover, a well-trained staff also in other, e.g. operational, central bank departments can contribute to the good reputation of the bank in the public, thus enforcing its credibility.[108]) In general, the central banks of the CEEC-5 have thoroughly invested in their human capital in the last years, recruiting highly qualified staff and providing numerous training opportunities at home and abroad.

A related issue which is of particular importance for transition economies is the remuneration of central bank employees. While some of the CEEC-5 central bank laws contain provisions with regard to the remuneration of top officials (see below), this issue is generally not regulated for central bank staff. Especially in transition economies, where wage levels in the private sector are particularly attractive as compared to the public sector, it is extremely important which yardstick is applied to determine the wage level for central bank employees. In our view, it is advisable to orient the remuneration of the central bankers towards wage levels in the (private) commercial banking sector in order to stop the considerable brain drain already taking place. As the experience of technical assistance and training for the staff of central banks in transition economies has shown, there is a very high fluctuation rate especially for the young central bank personnel, who are typically attracted to positions in the central bank because of interesting training possibilities and who, once they have been trained, change to the private sector due to uncompetitive wage levels in the central bank. Although losses due to this brain drain represent opportunity costs that cannot easily be quantified, a number of central banks should consider redesigning wage schemes (as well as fringe benefits), taking into account the wage structure in the commercial banking sector. Only the Hungarian and the Polish central bank laws contain provisions on the remuneration of the central bank's top officials. According to the Hungarian legislation, it is the duty of the bank's General Meeting to determine the wages of the Governor, the Deputy Governors and the other members of the central bank Council. The Polish law only contains a notion that the remuneration of the President and the Deputy Presidents is determined "in accordance with the … remuneration for persons holding state managerial positions … on the basis of an average pay in the banking sector,"[109]) thus providing a yardstick for the level of remuneration. However, the question who determines the remuneration of the central bank's top officials and by what criteria their remuneration is set can have implications for the independence of their behavior.

5.3 The Practice of Financial Independence

Although direct central bank credit to the government is legally restricted in all of the CEEC-5 and only permitted under certain conditions which are predetermined by law (see Table 2), in practice these restrictions have sometimes been overruled by the parliaments of some countries through the adoption of budget laws suspending this prohibition.[110])

The most prominent example in this area is Poland, where every year Parliament suspends Article 34 of the Act on the National Bank of Poland, which exactly specifies the maximum amount of state securities the central bank is allowed to buy on the primary market. After suspending Article 34 of the central bank law, the Polish Parliament then determines the amount of government securities to be purchased by the bank through the adoption of the budget law, thus overruling the central bank law. However, as the new draft constitution prohibits direct central bank credit to the government, the practice of overruling by a simple majority in Parliament will no longer be possible once the new constitution is endorsed.

Another case in point is Hungary before the most recent amendment of the central bank law. At that time, budgetary financing by the central bank was allowed up to a daily limit of 3% of planned annual revenues of the central budget of that year. Moreover, in the original law, a transitory clause permitted unlimited financing in 1992, while the thresholds for 1993 and 1994 were set at 5 and 4% of planned annual budget revenues respectively. The latter limit, however, was effectively raised to approximately 6% of targeted revenues, as the 1994 budget law obliged the central bank to finance a budget deficit up to an amount of HUF 80 billion. To our knowledge, the one and only case of overruling occurred in 1994. As of 1997, there remains only one relatively minor exception to the prohibition of budgetary financing by the central bank (see 4.3).

Other countries did even not use the possibilities for direct lending to the government within the limits stipulated in the central bank laws, which was not particularly difficult for states that did not record any budget deficit. For example, the Bank of Slovenia has never made use of this possibility since its establishment in 1991. In practice, the question of budget deficit financing by the central bank constitutes a source of conflict between the ministry of finance and the central bank in all countries facing a fiscal deficit and is often a highly debated issue.

A potential source of conflict between the central bank and parliament may arise from the provision that the central bank's budget has to be approved by parliament. A conflict with parliament, for instance on excessively high wages, could eventually lead to public criticism and to a loss of credibility and independence.[111]) In the countries examined, only the Slovene central bank law requires that the financial plan of the bank, which is adopted by the Governing Board of the Bank, be approved by Parliament. However, up to now no conflict between the Parliament and the Bank of Slovenia has emerged on this issue.

As mentioned earlier, the performance of a central bank cannot be measured on the basis of its profit and loss account. However, if a central bank does record losses, it is extremely important for its reputation to

explain to the public the origins for these losses and the ways and means to cover them. At the same time, the bank has to make clear that these losses are of a temporary nature and will be quickly eliminated. An interesting case in point is the Czech National Bank, which recorded a loss in 1996. As the Czech central bank law does not contain any provisions regarding the coverage of potential losses, it is interesting to note that – according to the spokesman of the bank – the loss will be covered from future profits[112]) and not from the state budget. This example shows that the necessary financial autonomy of the central bank could be maintained in practice even in the absence of legal provisions.

5.4 Policy Coordination Mechanisms in Practice

It is widely acknowledged that a central bank should coordinate its monetary policy with fiscal (and incomes) policies in order to achieve optimal overall results for the economy. The extreme model of an "absolutely" independent central bank can be equated to noncoordination between monetary and fiscal policies or even to the pursuit of a contradictory policy stance. This extreme model would imply the danger of policy conflicts between the government and the central bank, thus worsening the overall economic performance of a country.[113]) Therefore, it is often recommended that a certain degree of cooperation between the central bank and other economic policymakers be provided for by law. This is reflected in a number of provisions of central bank laws in Western Europe as well as in the CEEC-5, which determine different forms of coordination between central banks and governments in designing monetary and fiscal policies (see e.g. Table 1). However, this coordination has to be implemented in the practice of political life: In this context Proske[114]) emphasizes the importance of an institutional framework as a basis for coordinated policies, inter alia highlighting the model of the Austrian social partnership as an example of successful coordination of economic policies in practice. He examines the relationship between the degree of corporatism and various economic indicators in a number of Western countries[115]) and shows that there is a significant negative correlation between the inflation rate and the degree of corporatism. Moreover, he finds a highly significant negative correlation between the unemployment rate and the degree of corporatism and concludes that countries with a high degree of corporatism have not only achieved price stability, but at the same time have been able to reduce the potential costs of anti-inflationary policies.

However, in practice the degree of actual cooperation between the central bank and the government is determined by a number of additional factors, such as the personality of the central bank governor (and, of course, his counterpart in the ministry of finance) as well as by the political affiliations which typically prevail in the two institutions. In Poland, for example, there is a long-standing debate between the central bank and the Ministry of Finance on the role and the status of the central bank, which is reflected by the long delay in adopting a new central bank law and the dispute on this issue. Despite several years of negotiation, the central bank and the Ministry of Finance have failed to reach agreement on two –

substantially differing – central bank law projects. Moreover, the central bank Governor's campaign for the presidential elections in fall 1996 against the candidate of the ruling government coalition has certainly not contributed to improving cooperation between the central bank and the government. In Hungary, on the contrary, the elaboration of the stabilization program of March 1995 jointly by Lajos Bokros, the Finance Minister at that time, and central bank Governor György Surányi provides a good example of successful cooperation between the central bank and the government. Another example of smooth cooperation between the central bank and the government is Slovenia. Also, the Czech Republic generally enjoyed a good cooperation (see 5.2). However, in one of the few visible instances of disagreement between Governor Tošovský and Prime Minister Klaus – which was on the early introduction of capital account convertibility proposed by the bank in 1993 – Tošovský was overruled by Klaus.[116]) During recent months, the government has repeatedly criticized the central bank's monetary policy stance as being too restrictive.

6 Conclusions

Reviewing the central bank laws in the CEEC-5, we can state that the central banks in these five countries generally enjoy a relatively high degree of legal CBI, even when the strict requirements of the Maastricht Treaty are applied as a benchmark. The weakest point in the existing legislation, however, concerns the regulations on direct central bank lending to the government, which in principle is still permitted, though largely constrained, in all countries examined in this paper. These clauses will have to be changed for the countries analyzed to meet the requirements set by the Maastricht Treaty, at the latest when they join the European Union. Progress in this direction is clearly underway in the CEEC-5, which is reflected in the recent amendments of central bank laws (e.g. Hungary) or planned law projects (e.g. Poland, Czech Republic). Generally, we see a growing awareness of the importance of CBI, a topic increasingly discussed in the countries analyzed.

As regards actual CBI, a somewhat more diversified picture emerges: Although the legal status of the central bank top officials is well protected by law, the central banks of some countries are not free from actual political interference. The second major weakness lies in the practice of some national parliaments (e.g. in Poland) to overrule the central bank law in the field of direct budgetary financing. However, also in this area improvements are close at hand.

We are convinced that a high degree of legal central bank independence in the CEEC-5, together with a high extent of actual CBI, was and still is necessary to build up the needed credibility of monetary policy in a period of economic transformation and stabilization. Moreover, a further strengthening of both legal as well as actual CBI will be of crucial importance in order to fulfill the requirements of the Maastricht Treaty in view of future EU membership.

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1 *Both Foreign Research Division of the Oesterreichische Nationalbank. The standard disclaimer applies. We gratefully acknowledge the valuable comments of Peter Backé, Eduard Hochreiter, Margarethe Quehenberger and Doris Ritzberger-Grünwald.*

2 *Our analysis focuses on the Czech Republic, Hungary, Poland, Slovenia and the Slovak Republic (CEEC-5).*

3 *Treaty on European Union, in the following referred to as "the Treaty" or "the Maastricht Treaty" (1992).*

4 *See, e.g., Pönisch (1991) or Sundararajan (1990).*

5 *Except for the Polish central bank law, which is the only remaining central bank act from the pretransition period and which was already adopted in 1989, all other CEEC-5 central bank laws date from the years 1990-1992. However, the Polish law was amended several times (most recently in 1996). A draft for a new Polish central bank law has been debated in the last years, but has not yet been adopted by Parliament.*

6 *It must be noted, however, that all transition economies had to rebuild and modify their institutions.*

7 *This circumstance, of course, also applies to the successor states of the Former Soviet Union, where the former branches of the USSR Gosbank had to be transformed into independent central banks, as well as to the successor states of former Yugoslavia.*

8 *As a case in point, the last amendment to the Hungarian central bank law was approved by Parliament in December 1996 and went into force on January 1, 1997.*

9 *See Cukierman (1995).*

10 *For a comprehensive overview of CBI literature see Eijffinger and De Haan (1996) or Pollard (1993).*

11 *See S. Fischer (1995a).*

12 *See, e.g., Eijffinger and De Haan (1996).*

13 *See S. Fischer (1995b).*

14 *A prominent example of this approach is New Zealand, where the remuneration of the central bank Governor is linked to the realization of the targeted inflation rate.*

15 *Persson and Tabellini (1993), Eijffinger and De Haan (1996).*

16 *While both extremes, namely an entirely dependent as well as a fully independent central bank, can be clearly defined, it is extremely difficult to determine a threshold above which a central bank can be qualified as "independent," i.e. where the minimum critical mass for CBI is to be located.*

17 *See, e.g., Pollard (1993).*

18 *See Proske (1995).*

19 *See A. Fischer (1996).*

20 *See Eijffinger and Schaling (1993).*

21 *See Bade and Parkin (1980).*

22 *As cited in Eijffinger and Schaling (1993).*

23 *See Grilli et al. (1991).*

24 *See Eijffinger and Schaling (1993).*

25 *See Cukierman (1992).*

26 *The Cukierman survey includes prereform legislation in Hungary, Poland, Yugoslavia and Romania.*

27 *See Eijffinger and Van Keulen (1995).*

28 *See, e.g., Hochreiter et al. (1996).*

29 *See Hochreiter (1994) and Hochreiter and Riesinger (1995).*

30 *See Cukierman (1995).*

31 *See, e.g. Alesina and Summers (1993). However, some economists found that higher CBI can lead to stronger recessions during disinflation processes. See, e.g., A. Fischer (1996).*

32 *See, e.g., Krzak (1996).*

33 *Moreover, a number of Former Soviet Union (FSU) countries have recently strengthened CBI. For a comprehensive overview of central bank reform in the FSU, see Sundararajan et al. (1997).*

34 *See Cukierman (1995).*

35 *The European System of Central Banks (ESCB) comprises the European Central Bank (ECB) and the national central banks (NCBs).*

36 *The only partial exception to these obligations relates to the United Kingdom. In case this country chooses to exercise its EMU opt-out clause, the United Kingdom will not be obliged to make the Bank of England independent. (See Protocol 11 on certain provisions relating to the United Kingdom of Great Britain and Northern Ireland).*

37 *See Maxfield (1995).*

38 *As the EMI's interpretation of regulations laid down in the EU Treaty and the ESCB Statute is of particular relevance for central banks, we will repeatedly refer to EMI interpretations in our analysis.*

39 *See Banaian et al. (1993).*

40 *See Bank of Japan (1995) and Bruni (1995).*

41 *We are well aware that the issue of accountability is a "horizontal" aspect of CBI and is related to the other four categories described above. However, in our view this issue is particularly relevant with regard to the Maastricht requirements and deserves to be covered under a separate item.*

42 *See Article 9.1 of the Act on the Czech National Bank (1992), Section 12.2 of The National Bank of Slovakia Act (1992) and Article 2 of The Law on the Bank of Slovenia (1991).*

43 *See Article 6 of the Act on the National Bank of Hungary (1991).*

44 *See Cukierman (1992).*

45 *Protocol on the Statute of the European System of Central Banks and of the European Central Bank, in the following referred to as the Statute.*

46 *See, e.g., Swinburne and Castello-Branco (1991).*

47 *See European Monetary Institute (1996).*

48 *See Hochreiter and Riesinger (1995), where the 10 associated countries are reviewed.*

49 *See e.g. Bank of Slovenia, Annual Report 1995.*

50 *See EMI (1996).*

51 *"Without prejudice to the objective of price stability, the ESCB shall support the general economic policies in the Community..."(Article 105 [1] of the Treaty).*

52 *See European Monetary Institute (1996).*

53 *Aspects of accountability are dealt with in section 4.5 of this paper.*

54 *In practice, the CEEC-5 pursue the following exchange rate regimes: fixed peg (Czech Republic and Slovakia), crawling peg (Hungary), crawling band (Poland) and managed float (Slovenia). For details see Radzyner and Riesinger (1996).*

55 *See Article 46.2 of the Act on the National Bank of Hungary (1991).*

56 *However, the new draft constitution of Poland, which was adopted by the National Assembly at the beginning of April 1997 and still has to be endorsed by referendum on May 25, 1997, will change this stipulation: The monetary policy guidelines will be presented to Parliament only for its information. A change of the central bank law in this sense would bring about a substantial enforcement of CBI.*

57 *See S. Fischer (1995b).*

58 *For the specification of the operational framework see European Monetary Institute (1997a).*

59 *According to the new draft constitution, the central bank will be endowed with the sole right to determine and implement monetary policy.*

60 *The right to issue central bank securities is of particular importance in the absence of government papers (surpluses or balance of the state budgets), because in this case they constitute the only instrument available for the sterilization of capital inflows on the domestic market (e.g. Czech Republic and Slovenia).*

61 *See Article 33 of the Act on the National Bank of Poland (1989), Article 33 of the Act on the Czech National Bank (1992), Section 27 of The National Bank of Slovakia Act (1992), Article 25.4 of The Law on the Bank of Slovenia (1991).*

62 *See Bade and Parkin (1988).*

63 *The extreme case in this respect is a Currency Board arrangement: With the exchange rate being fixed vis-à-vis a low-inflation currency, the ability of the central bank to create domestic credit is limited by law*

to the countervalue of incoming foreign exchange. Such arrangements are in operation in Estonia and Lithuania and are currently being debated for Bulgaria.

64 *See Cukierman (1992).*

65 *We will not deal with the issue of seignorage, as this would go far beyond the scope of this paper. For an analysis of seignorage in selected transition countries see Hochreiter et al. (1996).*

66 *See, e.g., Cottarelli (1993).*

67 *See EMI (1996).*

68 *See Cottarelli (1993) and Leone (1991).*

69 *See Backé and Lindner (1996).*

70 *It should be noted that the draft constitution explicitly prohibits direct central bank lending to the government.*

71 *The National Bank traditionally had the function of raising funds on the international capital markets; from this activity the Bank had incurred sizeable losses due to subsequent forint devaluations. The exchange rate losses on these foreign liabilities had been accounted as non-interest-bearing nonmaturing central budget debt to the NBH. Now the central budget will issue forex-denominated bonds to the NBH in exchange for the non-interest-bearing debt, plus part of the government bonds the NBH received in earlier conversion of the former debt. See Reuters, December 18, 1996.*

72 *See Neumann (1991).*

73 *In this context Neumann (1991) takes an extreme position and demands a sufficiently long, single term of office (minimum of 10 years, ideally between 15 and 25 years) with no possibility of reappointment.*

74 *See, e.g., Cukierman (1992) and Grilli et al. (1991).*

75 *See EMI (1996).*

76 *See EMI (1996).*

77 *These qualification requirements were introduced by the most recent amendment, see Article 58.3 of the Act on the National Bank of Hungary (1991, as amended in 1996).*

78 *See, e.g., S.Fischer (1995b).*

79 *See Zulu et al. (1994).*

80 *See EMI (1997b).*

81 *See EMI (1997b).*

82 *For the monetary strategies pursued by the CEEC-5, see Krzak and Schubert, also in this issue of Focus on Transition.*

83 *See Bank for International Settlements (1996).*

84 *See Article 3 of the Act on the Czech National Bank (1992) and Section 3 of The National Bank of Slovakia (1992).*

85 *See Articles 41 and 48 of the Act on the National Bank of Hungary (1991) and Article 20.1.2 of the Act on the National Bank of Poland (1989).*

86 *A case in point is Russia, where the central bank, "although it is legally independent from the central government (sic!), is answerable to parliament, whose members probably act as the representatives of loan hungry constituencies" (see Cukierman, 1995).*

87 *See Cukierman (1995).*

88 *See Bruni (1995).*

89 *See, e.g., Neumann (1991).*

90 *See Konstytucja Rzeczypospolitej Polskiej (1997).*

91 *See Bruni (1995).*

92 *Cukierman (1995) argued this point even more strongly.*

93 *See Cukierman (1995).*

94 *See, e.g., Cukierman (1992).*

95 *See Cukierman (1992).*

96 *Consequently, the starting dates for the Czech Republic and the Slovak Republic differ from each other and from the date of their formation as two independent states. As the Polish central bank law dates from the prereform period, the reference period is longest and starts even earlier than the "Big Bang." In Hungary, the promulgation of the central bank law took place only in December 1991, even though political consensus on the status of the central bank had already been reached in mid-1990. However, we wanted to avoid arbitrarily setting starting dates for the different countries and preferred a transparent and unbiased criterion to set the reference period.*

97 *An interesting example was the amendment of the Bulgarian central bank law in April 1996, which enabled Parliament to suspend the terms of the central bank Governor and Vice-Governors without prespecified reasons by a three fifths majority of the deputies.*

98 Surányi had signed a charter reaffirming democratic values a few months before, thus criticizing the government. This document, as the Prime Minister said, suggested that freedom of speech was somehow in danger in Hungary at that time.

99 See Reuters, January 10, 1995.

100 See Reuters, selected reports from the period 1990 to 1997.

101 See Cukierman (1993).

102 As cited in Cukierman (1993).

103 We did not analyze the Czech Republic, the Slovak Republic and Slovenia in this respect, because the period of reference is relatively short for these countries and the turnover rate of governors was low to begin with.

104 In Poland, for example, inflation was brought down from 586% in 1990 to 20% in 1996 (CPI, annual average).

105 See Business Central Europe, May 1995.

106 See Business Central Europe, May 1995.

107 See Cukierman (1992).

108 See, e.g., Pönisch (1991).

109 See Article 56 of the Act on the National Bank of Hungary (1991) and Article 49.7 of the Act on the National Bank of Poland (1989).

110 An illustrative example outside the CEEC-5 is Russia in 1993, where central bank Governor Gerashchenko and Finance Minister Fyodorov were in constant disagreement on the source of Russian hyperinflation. Interestingly, it was the reform-minded finance minister who claimed a more restrictive monetary policy stance and who criticized the practice of budgetary financing by the central bank. This dispute finally led to Fyodorov's resignation in January 1994, after his repeated demands for Gerashchenko's dismissal had not been met (see Reuters, 1993 and 1994).

111 See Cottarelli (1993).

112 See Reuters, January 22, 1997.

113 See Pollard (1993).

114 See Proske (1995).

115 Proske (1995) examines Austria, Germany, the Netherlands, Sweden and Norway as the group of highly corporatized countries, followed by Denmark, Finland, Belgium, Japan, New Zealand and the UK with a medium level of corporatism and France, Italy, Australia, Canada and the U.S.A. with a very low degree of corporatism. The examined time series covers the period from 1970 to 1991.

116 See Reuters, March 11, 1994.

Editorial close: May 2