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Institutional Developments and Accession to the European Union: The Perspective of the Banca Națională a României

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Romania was one of six countries invited to start negotiations for accession to the European Union (EU) in December 1999, while negotiations effectively began in early 2000. Negotiations were subsequently finalized in December 2004 and the Accession Treaty was signed in April 2005, with an official membership target date of January 1, 2007. The prospect of EU membership has exerted a crucial role in providing a consistent direction for policy efforts, structural adjustment and institutional development overall in Romania, not just in what concerns central banking, and continues to be the essential reference for shaping the domestic legal, policy making and implementation, as well as structural adjustment agenda, given the authorities' shared target date for EU accession. Importantly, continued substantial public support for EU membership has kept the accession agenda paramount despite normal democratic political turnover.

Even before the start of official negotiations, the Banca Națională a României (BNR) had already been engaged in a process of modernization and institutional transformation which was informed by evolutions in the EU field, so that examining the setting in which this transformation took place is in itself worthwhile. Changes essentially took place along four principal lines: legal underpinnings, organization and management, regulatory and supervisory activity, as well as technical and operational aspects related to monetary policy.

In what concerns the legal underpinnings, a first instance of harmonization is found in the specifications of the second statute of the Romanian central bank (Law 101/1998), which was part of a package of laws concerning the banking sector² and which incorporated several improvements over preceding legislation, the

¹ The usual disclaimers apply.

² The package consisted of the Bank Privatization Law no. 83/1997, together with the Banking Law no. 58/1998 and Law no. 83/1998 on the bankruptcy and liquidation proceedings applicable to credit institutions.

motivation for these improvements being explicitly related to the EU integration perspective and the trend of globalization in financial markets. Indeed, the BNR stated that, as an accession candidate country central bank, its objective for 1998 and beyond was not only the continuation of domestic reform processes, but also incorporating the *acquis communautaire* and ensuring legal, institutional and procedural compatibility with corresponding institutions at the EU level.³

The objective of price stability became fundamental in this Statute (although mediated through the joint objective of stability of the currency), reflecting both the modern central banking canon and increasing calls from academia for monetary policy effectiveness through concentration on the single objective of disinflation⁴, while the central bank's sphere of competence was also clearly spelled out (designing and implementing monetary, foreign exchange, credit and payments policy, together with prudential regulation and supervision, monetary issuance, organizing and overseeing the payments system, as well as administering international reserves), together with the range of operations and policy instruments that could be employed by the BNR, and which for the first time relied consistently on indirect instruments and market operations.

In the 1998 Statute, independence from government was strengthened in both the formal and functional sense, with the bank being subordinated to Parliament. Most notably, the government's ability to draw financing from the BNR was limited: despite the fact that legislation no longer authorized deficit finance, shallow and weakly developed financial markets made it possible as an exception for the central bank to issue market rate loans with a maximum maturity of 180 days to meet temporary imbalances between Treasury revenues and payments. As also noted by the EU Commission 1998 report, the BNR was relieved of its obligation to grant special loans to companies and agricultural enterprises.⁵ Personal independence was bolstered by the mention of incompatibility between explicit political affiliation, public office and eligibility for a BNR Board position (including the prohibition for bank staff, outside of their professional mandate, to carry out any other activity than teaching), as well as by restrictive dismissal conditions for Board members. Also, the 1998 BNR statute allowed for the initiation of organizational reform of the central bank, given its definition of core and key areas essential for the focus of central bank activity.

Since the BNR had grown over time in both functions performed and number of employees, a rethinking of its organization with a view to improving effectiveness became increasingly necessary. On the basis of an external organizational audit performed in 1998, a streamlining process centered on core business and key

³ BNR Annual Report 1997, pp. 140; 148.

⁴ Popa, 1998.

⁵ Commission Reports COM(98) 702 final and COM(1999) 510 final (not published in the Official Journal).

activities, the spinning off or downsizing of non-core activities and the promotion of new functions, as well as on shortening the communications and decision-making chain between executive management and experts including through a substantial reduction in the number of departments and in the branch network took place (in three steps) between 1999 – 2001 (see table below).

Table: Developments in BNR Staffing and Organizational Structure

	Number of employees			Number of departments/branches	
	Total	Headquarters	Branches	Headquarters	Branches
Aug. 31, 1999	4,829	1,465	3,364	10 general departments 32 departments 101 divisions	41
Sept. 1, 1999	3,804	1,108	2,696	15 departments 51 divisions	41
Sept. 1, 2005	1,764	738	1,026	19 departments* 58 divisions*	19

*Note: * including departments created since 2001 and their respective divisions: European Integration and International Relations, Modeling and Forecasting, Financial Stability, Internal Audit.*

The result has been a smaller number of staff, while executive management coordination has since taken place along three key pillars: monetary policy (including European integration), operations, and prudential regulation and supervision, respectively. As such, the BNR gained in horizontal communication at expert level through the smaller structure achieved after its organizational transformation (an element which would prove important in tackling issues whose gamut runs across departmental responsibility frontiers, such as the implementation of the inflation targeting regime or the Basle II effort). New departments were also created, reflecting an improved focus of the central banks on key areas of activity in state of the art institutions of its kind (autonomous financial stability, internal audit, and modeling and forecasting departments). All these organizational changes have amounted to increased institutional flexibility and an improved capacity of the central bank to adapt – including in what concerns resource allocation and administrative capacity – to the new challenges posed both by the integration perspective and by an evolving macroeconomic and financial environment.

One of the outcomes of the organizational reshaping of the bank has been the creation in early 2002 of a new European Integration and International Relations department, whose functions had previously been subsumed in the Monetary Policy department and several other operational departments of the central bank. Given the ambitious and broad EU integration agenda of the BNR and the increased effort this required, the new department was substantially staffed and assigned a six fold mission (aside from the usual international relations agenda):

- (i) to coordinate the achievement of EU integration-related programs which involve the BNR in terms of their objectives and responsibilities, as well as to monitor the adaptation of banking system institutions, practices and standards in light of EU accession and membership requirements;
- (ii) to coordinate BNR participation in accession negotiations on the three chapters in which the central bank was prominently involved, these being chapters 3 – Free Movement of Services, 4 – Free Movement of Capital and 11 – Economic and Monetary Union, as well as to monitor and coordinate the fulfillment of BNR commitments resulting from these negotiations, including through screening of draft legislation;
- (iii) to coordinate and draft BNR contributions to Romania’s pre-accession economic programs, as well as other key documents with national vocation (National Plan for European Integration, National Development Plan) presented to the European Union;
- (iv) to provide the coordination and collaboration interface with EU institutions, primarily the ECB and the European Commission, ranging from participation in the Accession Committee and relevant sub-committees to exchanges of information, visits and, after April 2005, to coordinating the participation of BNR staff as observers in ECB structures and the EFC;
- (v) to monitor progress in the BNR accession effort according to the central bank’s Masterplan and regularly report to executive management and the BNR Board of Administration on the results thereof;
- (vi) to coordinate non-reimbursable assistance under PHARE programs, including an important twinning effort ongoing since early 2000 with central banks from several EU Member States (France, the Netherlands, Italy and, more recently, Portugal).

Throughout, the department has been involved in providing support for the BNR’s periodic consultative participation in the European Integration Committee chaired by the Ministry of European Integration, as well as in the Pre-Accession Agricultural Instrument (SAPARD) Monitoring Committee (given the BNR’s role as depository institution for the euro SAPARD account).

The BNR’s participation in PHARE-assisted activities took place with financing from the 1998, 2001 and 2003 programs. The different programs (twinning, supplemented in certain instances by twinning light, as well as programs with an

individual focus), coordinated by a PIU, were initially centered on institution building, through improvements in the central bank's supervisory capacity (early warning and bank rating system), upgrading of BNR's staff skills in statistics, bank operations, legal, internal audit, and European integration, supporting investment in technical infrastructure for the new balance of payments statistics system, cash operations, banking operations and accounting, as well as on optimizing the bank's treasury activity through the implementation of straight-through processing. More recently, these efforts have also concerned implementing and fully transposing several of the EC directives, subject to negotiation commitments under chapter 3 – Freedom to Provide Services, and given revisions of said EU legislation. Also, some of the twinning program components have widened their targets beyond the date of starting twinning activities in the light of meeting Basle II requirements, with program savings in terms of funding and man-hours devoted to the latter end.

The BNR has made a comprehensive and persistent effort on *acquis* transposition. *Acquis* conformity has been achieved, with outstanding efforts in what concerns credit institutions currently focusing on Basle II and the transposition of legislation on financial conglomerates. The full transposition of chapter 3 *acquis* was performed by amending a legal basis – the 1998 Banking Law – already configured accordingly with regard to Basle Committee principles and generally aligned with EU legislative developments at the time it was adopted. Amendments mainly dealt with the legal framework for ensuring the right of free establishment and free provision of services by credit institutions from the Member States, based on the principle of the mutually recognized single license as well as with implementing the principle of the supervision of the credit institutions by the competent authority from the home Member State.⁶

It is important to point out that the legislative overhaul did not only concern primary legislation. Comprehensive *acquis* transposition efforts took place on a background of improved secondary legislation, including in the aftermath of the difficult period of banking sector clean-up in 1999–2000, as well as the renewed effort to fight against money laundering and financing of terrorist organizations and activities after September 11, 2001. Regulatory and prudential improvements on major topics, such as capital adequacy and market risk (transposing Directives 93/6/EEC, 98/31/EC and 98/33/EC)⁷, went hand in hand with improvements in supervision, both in terms of legal provisions – those on supervision of solvency and large exposures of credit institutions and on the internal control system of

⁶ Via Laws no. 485/2003 and 443/2004 amending and supplementing Law no. 58/1998 on banking activity, as further amended and supplemented. These, together with other secondary legislation, transposed Directives 2000/12/EC, 2000/28/EC, 2000/46/EC and 2001/24/EC.

⁷ Via BNR Rules no. 5/2004 on credit institutions capital adequacy.

credit institutions and the material risk management⁸, for example – as well as in what concerns developing and improving a CAMEL-type early-warning system based on comprehensive periodic internal rating of credit institutions, more frequent on-site inspections and focused supervisory efforts. Legislation on insolvency of relevance to the Eurosystem (Directive 2001/24/EC)⁹, on collateral and enforceability of contracts (Directive 2002/47/EC)¹⁰, on e-money institutions (Directive 2000/46/EC), on harmonizing the deposit guarantee scheme (Directive 94/19/EC), as well as regulations on annual accounts and consolidation of accounts (Directive 86/635/EEC)¹¹ were also transposed.

The BNR also took steps to regulate and supervise new types of credit institutions. During 2002 the Banca Națională a României licensed the Central House and the 547 affiliated credit co-operative organizations of the CREDITCOOP network, which have been under BNR supervision starting Sept. 2002.¹² Also, in May 2004 the BNR authorized the first collective saving and lending bank for housing.¹³

⁸ On an individual and consolidated basis, as provided in BNR Rules no. 12/2003; also, BNR Rules no. 17/18.12.2003 on organizing the business process as well as the organization and performance of internal audit activity in credit institutions.

⁹ As provided by Romanian Government Ordinance no. 10/22.01.2004 on the procedure for judicial reorganization and winding up of credit institutions (approved by Law no. 278/2004). The provisions concerning the winding up of a bank ordered by the Banca Națională a României or at the initiative of the shareholders have been transposed in the Law no. 58/1998 on the banking activity, as further amended and supplemented.

¹⁰ By Romanian Government Ordinance no. 9/22.01.2004 concerning certain financial collateral arrangements (approved by Law no. 222/2004).

¹¹ This was achieved through BNR Rules no. 8/2002 (replaced by BNR Order no. 5/22.12.2005) on drawing up the consolidated financial statements by credit institutions, as well as by BNR Rules no. 9/2002 on banks' accounting for derivatives and drawing up the related financial statements, together with Rules no. 10/2002 on financial derivatives and Rules no. 11/2002 supplementing BNR Rules no. 8/1999 on limiting banks' credit risk.

¹² As regards the legislation applicable to the credit cooperative organizations, significant progress was achieved by issuing Law no. 122/2004 amending the Government Emergency Ordinance no. 97/2000 on credit cooperative networks. In this field, BNR issued Rules no. 7/2004 on licensing of credit cooperatives laid down in article II, paragraph (1) of Law no. 122/2004 amending Government Emergency Ordinance No. 97/2000 on credit cooperatives and Rules no. 8/2004 amending and supplementing BNR Rules no. 13/2002 on the minimum capital of the credit cooperatives organizations and on the minimum aggregate capital of credit cooperative networks.

¹³ The legal framework providing for the set up and operation of collective saving and lending banks for housing was established through Law no. 541/2002 on collective saving and lending for housing and the regulations regarding the specific conditions for the authorization and operation of these entities (BNR Rules no. 4/2003 on the

Subsequent to the 2003 FSAP (Financial Sector Assessment Program) exercise conducted jointly by the IMF and the World Bank, several EU peer review missions on financial sector issues were useful in assessing progress and flagging outstanding issues.

Remaining efforts on chapter 3 focus on the Basle II roadmap and on the adoption of legislation on financial conglomerates. While the latter has been scheduled for mid-2006 (with the draft bill having already been finalized in the technical working group), the Basle II roadmap is a more complex process. It has been scheduled in four phases, starting with the initiation of dialogue and exchange of information with the banking sector (May – Nov. 2005), followed by the development of supervision means consistent with the new capital agreement (Dec. 2005 – May 2006), the BNR validation of internal rating models of credit institutions (Jun. – Oct. 2006) and by verifying the implementation of the New Capital Accord provisions in the banking sector (starting with Jan. 2007). A steering committee was set up, coordinating the activities of five working groups (on legislation, capital and consolidated supervision, credit risk – for both the standard and the internal rating models approach, operational risk, and market risk).

At present, both the steering committee and the BNR Board have discussed the 52 national options in connection with the (draft) reconfigured Directive 2000/12/EC (of which 29 have been approved); further consultations with the Ministry of Public Finance, the National Securities Commission and the Romanian Banking Association are underway. Other activities being carried out include carrying out the quantitative impact study, finalizing the legislation transposing Basel II *acquis*, finalizing the internal rating model validation guides, together with a restructuring of the present prudential reporting system.

In terms of chapter 4, absorption of the *acquis* dealt with Directive 88/361/EEC regarding implementation of art. 67 of the Treaty.¹⁴ Transposition was also concerned with essential components of legislation dealing with payments systems and cross-border financial transactions: settlement finality in payments and securities settlement systems (Directive 98/26/EC)¹⁵, relations between financial

authorization of collective saving and lending banks for housing and BNR Rules no. 5/2003 on particular conditions for the operation of collective saving and lending banks for housing).

¹⁴ Absorption was achieved through the revised and amended Banking Law no. 58/1998, as well as by BNR Regulations no. 4/2005 and 6/2005 on the foreign exchange regime and BNR Rules no. 5/2005 on licensing foreign exchange operations, together with BNR Regulation no. 4/2002 on the transactions performed by means of electronic instruments and the relationship between the participants in these transactions.

¹⁵ This required a complex transposition, by means of Law no. 253/2004 on settlement finality in payment and securities settlement systems, provisions in Law no. 312/2004 on the Statute of the Banca Națională a României, as well as BNR Regulation no. 1/2002

institutions, traders and service establishments, and consumers in terms of an European Code of Conduct relating to electronic payments, as well as the relationship between card holders and card issuers (Recommendations 87/598/EEC, 88/590/EEC and 97/489/EC)¹⁶, together with cross-border credit transfers and other financial transactions (Directives 98/26/EC and 97/5/EC)¹⁷.

An important ingredient of BNR commitments under chapter 4 was the drawing up in 2002 of a schedule of gradual capital account liberalization which took into account the shallowness of Romanian financial markets and the need to sequence steps so as to minimize potential negative consequences for the economy as a whole while allowing for the favorable allocative effects of free capital flows to manifest themselves. As principles, longer-term flows were scheduled for liberalization before shorter-term, potentially volatile ones, while inflows were scheduled to be liberalized before outflows. After the crucial step of allowing free non-resident access to domestic currency deposits in April 2005, the outstanding steps remaining at the time of writing are non-resident access to domestic currency-denominated government securities (scheduled for Jan. 1, 2006) and access for both residents and non-residents to transactions in money market instruments (scheduled by Sept. 1, 2006).

The legislative transposition efforts of the BNR under chapter 11 have dealt with the adoption of a new central bank Statute (Law no. 312/2004), which is fully compliant with the relevant *acquis*¹⁸. This is visible through a multitude of improvements to previous legislation. First, the fundamental objective of the central bank has become ensuring and maintaining price stability, with no other qualifications. Second, independence has been consolidated and strengthened. The BNR pursues an independent monetary policy and is expressly forbidden to seek or accept any kind of outside advice on its policies. It supports the government policy agenda insofar as this does not affect the achievement of its own primary objective. Third, the central bank now informs the legislative rather than reporting to it and requiring approval on its activity, as in the past.

(r1) on the large funds transfer system and BNR Rules no. 7/2002 on funds transfers inside a network of credit cooperatives.

¹⁶ Transposed into Romanian legislation by BNR Regulation no. 4/2002 on the transactions performed by means of electronic instruments and the relationship between the participants in these transactions.

¹⁷ Reflected in Government Ordinance no. 6/2004 on cross-border credit transfers (approved by Law no. 119/2004), together with BNR Regulation no. 3/2004 on the mediation procedure for the settlement of disputes related to cross-border credit transfers.

¹⁸ Including monetary policy instruments and procedures of the Eurosystem, the application of minimum reserves, the collection of statistical information, consulting the ECB by national authorities regarding draft legislation, the legal framework for accounting and financial reporting within the ESCB, as well as professional secrecy.

Moreover, the privileged access of public institutions to financial resources is expressly prohibited: the BNR can only lend to credit institutions¹⁹, no credit (including overdraft facilities) may be extended to any other institution, corporation or individual, including public administration, local governments and state-owned companies (majority state-owned credit institutions being the exception here), and purchases of government securities may only take place in the secondary market²⁰, for the purpose of carrying out monetary policy decisions. It is worthwhile noting that legislation concerning the establishment and operation of the Bank Deposit Guarantee Fund was also adopted in 2004, which repeals the provisions under which the Fund was able to borrow from the BNR to supplement or meet large claims on its resources.²¹ The BNR does not hold any claims on government on its balance sheet, nor has it accepted non-sovereign corporate debt instruments as collateral so far, due to the liquidity and riskiness problems associated with the incipient level of development of domestic financial markets in such instruments.

The BNR has also focused on convergence with ECB regulations, standards and practices in the process of overhauling its array of policy instruments. A first instance of such convergence is BNR Regulation no.1/2000 on regarding the money market operations carried out by the BNR and the lending and deposit facilities it provides to banks. The regulation is consistent with ECB standards in defining open-market operations (with deposit taking and, starting 2004, CD issuance added to the available array) establishes eligible partners to perform money market operations (where so far only credit institutions have been granted eligibility), sets forth the assets eligible for trading and collateralization, the manner in which money market operations are performed, and the standing facilities granted to banks. A recent proposal modeled after ECB practice deals with the standardization of liquidity sterilization operations on a weekly basis, whereas CD issuance already conforms to this (albeit with monthly frequency).

Minimum reserves regulations are also to some extent similar to ECB practice: so far, only credit institutions are subject to reserve requirements, these are constituted for standardized monthly observation and application periods, there are different rates for domestic currency and foreign exchange denominated liabilities

¹⁹ For maturities of up to 90 days, against appropriate collateral (government securities or deposits).

²⁰ Along with reverse operations, outright purchases/sales or the granting of loans collateralized by the pledge of claims against or securities of the Government, national and local public authorities, régies autonomes, national corporations, national companies and other majority state-owned companies, credit institutions or other legal entities. The BNR may also conduct foreign exchange swaps, issue certificates of deposit and collect deposits from credit institutions, under the terms and conditions it deems appropriate for achieving its monetary policy objectives.

²¹ Law no. 178/2004.

(currently 16% and 30%, respectively, given the risks exerted by the relatively high and growing degree of credit euroization for both macroeconomic stability as well as in terms of the asset-liability mismatch) and, until recently, liabilities with maturities of over two years were exempt from reserve requirements.²²

The year 2005 has been an especially challenging one for the BNR, which has seen four long-prepared for projects come to fruition. Besides the important step of liberalizing non-resident access to domestic currency deposits, the central bank also carried out starting July 1, 2005 a 10,000-to-1 currency redenomination meant to signal the end of high and volatile inflation (Dec./Dec. CPI reached single-digit level for the first time in 2004), to reduce transaction and accounting costs, and to facilitate familiarization with exchange rate values closer to those of the countries which have adopted the euro in order to smooth inward and outward capital flows (dual banknote circulation will end on Dec. 31, 2006, while dual price posting was compulsory for all retailers from March 1, 2005). In addition, 2005 is the year of finalization of the TARGET-compatible electronic payments system, with its three components: real-time gross settlement, automated clearing house and the government securities settlement system.

Perhaps the most challenging project, however, has been the implementation of the new inflation targeting regime, prompted by the need to find a flexible yet robust policy regime that could better anchor expectations in delivering disinflation along the nonlinear and highly difficult path from 9% to 2–3%, and thus to facilitate the necessary nominal convergence with European Union economies. The previous regime, that of targeting monetary aggregates, had become troubled by the usual multiplier instability (which was seen as set to grow with financial development) and was sufficiently eclectic to induce consistency problems, whereas the option of exchange-rate targeting when confronted with a sizable interest rate differential and potentially significant inflows over a longer span of time (due to both capital account liberalization and an improvement in the country's risk perception, including as a result of the convergence play) was seen as considerably riskier than either remaining regime choice.

Detailed preparations for this switch started in 2003, with the design of a macroeconomic forecasting and simulation model as the technical centerpiece, together with a Board decision on the essential parameters of the strategy (targeting Dec./Dec. headline inflation for transparency and credibility reasons, despite sizable administered price adjustments; a central point target for the purpose of anchoring expectations, with a narrow $\pm 1\%$ band to prevent drift; a medium-run perspective translating into the initial announcement of current and subsequent year targets; the possibility to resort under very restrictive circumstances to a set of five

²² The blanket application of reserve requirements on all credit institution liabilities irrespective of maturity is perceived as a temporary derogation, in reaction to the widespread evergreening practice of local banks.

exception clauses in circumscribing central bank responsibility vis-à-vis the attainment of the inflation target; issuing quarterly inflation reports containing a 6–8 quarters ahead inflation forecast and a policy assessment including a detailed analysis of risks to the baseline scenario and presenting their main conclusions via press conferences; transparency in terms of the scheduling of dedicated Board policy meetings and the decisions thereof, via regular press statements). Two quarterly inflation reports were produced as part of a dry run effort meant to confirm the readiness of the bank in terms of the new strategy, before going public in August 2005. The entire effort received important technical assistance from the IMF and Česká národní banka.

An important final dimension of BNR preparations for EU accession is its proposed roadmap for euro adoption. After discussions in late 2003, a draft calendar put forth by the author was subscribed to by the BNR Board and has since become a standard element of the bank's presentations.²³ One dimension of this communication effort is germane to the central bank's role as public educator and seeks to raise the profile of the issue in Romania and to serve as a starting point for informed public debate that should lead to the building of a broad consensus which would be largely invariant to changes in government over the envisaged time horizon. Consultations with governments past and present have indicated implicit acceptance of the essential dimensions of the roadmap, but no official position has been expressed as yet, which – in light of the approaching 2007 accession target date – reinforces the need for timely public debate.

Based on the idea of the New Exchange-Rate Mechanism (ERM2) participation 3–4 years after accession, the BNR proposed roadmap tries to achieve a balance between considerably speeding up the timetable (thereby incurring costs induced by foregoing monetary and exchange rate support in furthering structural change, with a consequently larger burden to be borne by changes in the level of real activity and employment), and the option of stretching out the process substantially (thereby delaying the internalization of benefits important for an economy the size of Romania, such as lower transaction costs and the elimination of exchange rate risk, not to mention creating a potential negative impact on investor expectations from a further endpoint to the EMU process, which may induce ambiguous consequences on the evaluation of policy consistency and credibility). Given the substantial amount of structural adjustment that will still need to be effected in Romania, timing ERM2 participation 3–4 years after the date of accession would allow a limited *ex ante* amount of monetary and exchange rate policy flexibility that should, assuming public support for the roadmap, provide strong incentives for government front-loading of the structural reform agenda within the defined horizon, especially since this flexibility would cease to be an option after the expiration of the agreed time interval.

²³ This was first outlined in Popa, 2004.

A second consideration leading to a 3–4 year horizon before ERM2 participation being considered beneficial is the fact that, due to the important productivity differential between Romania and the EU, as well as given the relatively late inception of significant capital flows into the Romanian economy, it should be expected that substantial inflows will continue several years after accession. A more ambitious calendar would therefore run into the problem of additional complications to estimating the central parity as a reasonable proxy for the equilibrium exchange rate.

A third consideration supporting the BNR preference for this calendar takes into account the still considerable catching up process that Romania needs to undergo in terms of both nominal and real convergence vis-à-vis the EU. Importantly, a suitable preparation period prior to ERM2 participation would allow the Romanian economy to achieve most of the Maastricht criteria *ex ante* or make significant progress in this direction, thereby ensuring a higher likelihood of shortening the country's ERM2 participation period towards the two years prescribed by the Treaty. This would also go some length towards minimizing concerns (especially voiced by outside observers) that the existence of the $\pm 15\%$ exchange rate band could potentially create incentive problems for freely mobile capital flows in a protracted ERM2 environment. The latter concern is all the more visible when taking into account the fact that the BNR has recently moved to inflation targeting, a monetary policy regime where central bank credibility and its influence on declining inflation expectations is crucial; given a starting point of relatively high inflation, it is reasonable to expect the new regime to deliver consistent improvements over a medium-run perspective, rather than a short-termist one, and therefore help to bring inflation down towards levels compatible with the Maastricht criterion by the moment of entering ERM2.

All of the considerations described above reinforce the BNR preference for a 3–4 year preparation period before ERM2 participation; coupled with an expected 2–3 year stay within the mechanism, this would mean a final date for euro adoption in 2012–2014, given Romania's objective of EU membership in 2007. Taking into account the timetables for euro adoption currently being considered by the new EU Member States, Romania's proposed schedule appears to balance feasibility and ambition in a reasonable manner.

The Banca Națională a României has benefited from policy, organizational, managerial and administrative change induced or catalyzed by the accession process; it is, of course, not the sole public institution to do so. Accession has been important first and foremost as policy anchor, in that it has led – in a country-wide perspective – to more policy consistency (across time, as well as within the policy mix) and supported difficult decision-making by raising the stakes for avoiding policy mistakes and inconsistencies. Importantly, participation in preparations for EU accession has also meant a faster and more coherent institution building or modernization process through lower model search costs and has provided a

consistent paradigm on which to build future efforts (a situation of virtuous path dependence not often analyzed in economic literature).

In more concrete terms, value has also been added for the BNR through a longer-term monitoring process involving thorough screening of legislation and flagging areas of needed change to ensure consistency of the institution's strategic approach (and not just *acquis* absorption compliance), as well as via an entire array of consultations and exchange of views and information including, besides the expected interaction with EU bodies, a reliance on the broad array of experience from Member States' central banks (especially from those of the new Member States), together with dialogue and evaluation of developments as they unfold, as well as analysis of potential problem areas.

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