



OESTERREICHISCHE NATIONALBANK

Stability and Security.

WORKSHOPS

Proceedings of OeNB Workshops

*The European
Integration Process:
A Changing Environment for
National Central Banks*

October 21, 2005



No. 7



OESTERREICHISCHE NATIONALBANK

Stability and Security.

WORKSHOPS

Proceedings of OeNB Workshops

*The European
Integration Process:
A Changing Environment
for National Central Banks*

October 21, 2005

No. 7

The issues of the “Workshops – Proceedings of OeNB Workshops” comprise papers presented at the OeNB workshops at which national and international experts – including economists, researchers, politicians and journalists – discuss monetary and economic policy issues.

Editors in chief

Peter Mooslechner, Ernest Gnan

Scientific coordinator

Paul Schmidt

Editing

Rita Schwarz

Technical production

Peter Buchegger (design)
Rita Schwarz (layout)
OeNB Printing Office (printing and production)

Inquiries

Oesterreichische Nationalbank, Secretariat of the Governing Board and Public Relations
Postal address: PO Box 61, AT 1011 Vienna
Phone: (+43-1) 404 20-6666
Fax: (+43-1) 404 20-6698
E-mail: oenb.info@oenb.at

Orders/address management

Oesterreichische Nationalbank, Documentation Management and Communications Services
Postal address: PO Box 61, AT 1011 Vienna
Phone: (+43-1) 404 20-2345
Fax: (+43-1) 404 20-2398
E-mail: oenb.publikationen@oenb.at

Imprint

Publisher and editor:
Oesterreichische Nationalbank
Otto-Wagner-Platz 3, AT 1090 Vienna
Günther Thonabauer, Secretariat of the Governing Board and Public Relations
Internet: www.oenb.at
Printed by: Oesterreichische Nationalbank, AT 1090 Vienna
© Oesterreichische Nationalbank, 2006
All rights reserved.
May be reproduced for noncommercial and educational purposes with appropriate credit.

DVR 0031577

Vienna, March 2006

Contents

Editorial <i>Isabella Lindner, Paul Schmidt</i>	5
Welcome Address <i>Josef Christl</i>	10
Keynote Speech <i>Tommaso Padoa-Schioppa</i>	13
The Hrvatska Narodna Banka's Experiences in Preparation for the EU/ESCB Membership <i>Adolf Matejka</i>	19
Institutional Developments and Accession to the European Union: The Perspective of the Banca Națională a României <i>Cristian Popa</i>	36
Eesti Pank in the European Integration Process <i>Martin Põder</i>	49
Institutional Changes in the European Integration Process – the OeNB's Experience <i>Isabella Lindner, Sandra Dvorsky</i>	53
Comparing Central Bank Legislation in Southeastern Europe: Selected Cases <i>Sandra Dvorsky</i>	69
Strengthening the Guarantees for Independence of a Central Bank in Compliance with EU Requirements: The Case of Bulgaria <i>Rossen Grozev</i>	95
The Structure and Functions of the Türkiye Cumhuriyet Merkez Bankası <i>D. Derya Yeşiladali</i>	137
Legal Independence of the Narodna Banka na Republika Makedonija <i>Toni Stojanovski</i>	150

Checks and Balances for the European Central Bank and the National Central Banks <i>Carel C. A. van den Berg</i>	156
A National Central Bank within a Federal System <i>Philippe Bonzom, Christian Barontini</i>	172
The Development of the Division of Labour between the ECB and the NCBs <i>Alexandra Schober-Rhomberg</i>	185
Optimal Central Bank Design: Benchmarks for the ECB <i>Helge Berger</i>	197
Documenting FOMC Voting Patterns <i>Ellen E. Meade, D. Nathan Sheets</i>	230
The Future Voting Modalities of the ECB Governing Council <i>Dominique Servais</i>	246
Contributors	265
List of “Workshops – Proceedings of OeNB Workshops”	272
Periodical Publications of the Oesterreichische Nationalbank	273

Opinions expressed by the authors of studies do not necessarily reflect the official viewpoint of the OeNB.

The presented articles were prepared for an OeNB workshop and therefore a revised version may be published in other journals.

Editorial

*Isabella Lindner
Paul Schmidt*

Oesterreichische Nationalbank

The European integration process at its various stages poses different challenges for national central banks: first the economic and institutional preparation for EU-membership and the participation in EU-accession negotiations, second the integration into the EU and the European System of Central Banks (ESCB), and third the introduction of the Euro according to a well-defined blueprint and the participation in the Eurosystem's evolving division of labour.

It is against this background that the Oesterreichische Nationalbank (OeNB) labelled its traditional annual EU-workshop "*The European Integration Process: A Changing Environment for National Central Banks*". The high-level workshop was held at the premises of the OeNB in Vienna on October 21, 2005 and brought together more than 115 leading experts from central banks and the academia from 27 different countries.

Its sessions addressed the institutional and legal challenges for national central banks (NCBs) of EU-candidate and potential EU candidate countries drawing on central bank experience of "old" and "new" EU Member States and analysed relevant institutional aspects for national central banks within the Eurosystem, in view of its future enlargement.¹

In his opening remarks, *Josef Christl (OeNB)* drew attention to the decentralized nature of the ESCB and the Eurosystem and pointed out that the credibility NCBs enjoyed in their respective countries contributes largely to the success of the euro and hence of the European integration process. Christl called for a reinforcement of NCB cooperation in Europe and assessed the workshop as a step toward reaching this target. In times of institutional uncertainty and during the phase of reflection about the EU Constitutional Treaty it is particularly important to have a stable currency which promotes a common European identity far beyond the confines of Economic and Monetary Union (EMU). The single currency plays a key role as a catalyst for political integration and continued economic reforms.

¹ The opinions voiced by the speakers at this workshop are their own views and do not necessarily reflect the official position of the institution they represent.

By linking the supranational and national levels, the Eurosystem NCBs represent the communication interface of the European single currency. Moreover, the decentralized structure of the ESCB/Eurosystem enables the NCBs to contribute to the stability-oriented monetary and economic policy and to secure financial stability across the EU and at the national level.

According to Christl, the integration of the NCBs into the European decision-making mechanisms and forums changes these bodies' working methods at all hierarchical levels and in all areas of their work. The closer the cooperation among NCBs is, the more opportunities they have to develop and benefit from best practice. Efficient cooperation within the ESCB/Eurosystem and flexible, specialized NCBs are essential for the success of the euro.

In his keynote speech, *Tommaso Padoa-Schioppa* (former member of the Executive Board of the European Central Bank) laid the groundwork for the individual panels in the workshop by analyzing the changing tasks of NCBs in Europe in a historical context and highlighting different trends.

Historically, NCBs were monopolists who were solely responsible for the issue of banknotes. Central banks used the term "national" in their designations because it was the nation state that had the right to issue banknotes from the end of the 18th century onward. The term "central" referred to central banks' uniqueness, to centralized state structures and to a centralized exercise of power by the state. However, the central bank of the euro is not a national bank, nor is Europe a state. Had the economic and fiscal policy environment in Europe not evolved, no consensus could have been reached on the introduction of the euro and the building of the ESCB and the European Central Bank (ECB), nor would it have been possible to invest the terms "central" and "national" with new meaning.

What changed dramatically is the NCBs' role in fiscal policymaking and in commercial banking. The central banks' concentration on monetary policy tasks and the trend toward independence are achievements of the Treaty of Maastricht; hence, these are quite recent developments. The ESCB and Eurosystem are more independent than the individual NCBs, as it is not accountable to a single political body; any change in the ESCB/ECB Statute requires the consent of all 25 Member States.

Another trend, noted Padoa-Schioppa, is the internal reorganization of the NCBs. While the Bank of England never established a branch network, the structure of the Banque de France includes around 200 branches. Consequently, the introduction of the euro cannot be blamed for the closure of branches in some EU Member States. Summing up, changes in NCBs are also set in motion by global developments, and some of these changes should be seen independently of European integration, e.g. new tasks in safeguarding financial stability.

Session I: Preparing for EU/ESCB Membership

Panel I was entitled “Institutional Challenges for Central Banks – Comparing Experiences”. Central bank representatives from Croatia, Romania, Estonia and Austria provided an overview of organizational changes and new institutional requirements facing their banks.

Adolf Matejka (Hrvatska Narodna Banka), whose country has now begun EU accession negotiations, explained that Hrvatska Narodna Banka had just established an EU division and had restructured its banking supervision operations. Moreover, open market operations had just been introduced as a new monetary policy instrument. Within the framework of the Stabilisation and Association Agreement, Croatia is taking further steps to liberalize capital transactions.

Cristian Popa (Banca Națională a României) clarified that the *Banca Națională a României*, as the central bank of an acceding country, was focusing on internal restructuring activities that included a definition of the bank’s core competences, the closure of branches and the improvement of internal communications. Further challenges extend in particular to making progress with the liberalization of capital transactions, introducing inflation targeting, reforming the electronic payments system and redenominating the currency.

Martin Põder (Eesti Pank) noted that ever since Estonia joined the EU and its central bank became a member of the ESCB, Eesti Pank has been faced with a heavier workload, the manifold topics that the ESCB deals with and a greater coordination effort at the national level. The greatest challenges that Eesti Pank is confronted with is the fulfillment of the convergence criteria, the logistical and organizational preparation of the introduction of the euro and the justification of Eesti Pank’s role to the public.

Isabella Lindner (OeNB) provided a résumé of the impact of Eurosystem membership on the OeNB: In legal terms, the OeNB has transferred monetary sovereignty, whereas in real terms, it has gained influence on European monetary policymaking. The OeNB has remained responsible for the implementation of monetary policy at the national level. The demands on OeNB staff have risen. ESCB-wide harmonization, also at the legal level, is increasingly affecting many of the OeNB’s business areas. The OeNB has found niches and areas within the Eurosystem in which it can specialize. Another consequence is more emphasis on intercultural networking, lobbying and increased competitive pressure – albeit with a team spirit – within the Eurosystem.

Panel II dealt with “Adjusting Central Bank Legislation – Legal Challenges”. Central bank representatives from Austria, Bulgaria, Turkey and Macedonia discussed the need to amend central banking legislation when adopting the EU treaties.

Sandra Dvorsky (OeNB) provided an overview of the legal challenges for the three Southeastern European countries represented on the panel. *Rossen Grozev*

(*Balgarska Narodna Banka*), *D. Derya Yeşiladali* (*Türkiye Cumhuriyet Merkez Bankası*) and *Toni Stojanovski* (*Narodna Banka na Republika Makedonija*) presented the reform steps their banks had already taken or were preparing to take.

As each of these three countries is at a different stage of the European integration process, progress with legal adaptation also differs. Bulgaria's central banking law has largely been adapted to the EU Treaty provisions, whereas Turkey and Macedonia need to make further efforts to adapt legislation to EU standards. Above all, the central banks' independence needs to be strengthened, and the possibility of direct influence of the national government (Turkey) or parliament (Macedonia) on monetary policymaking must be limited.

Session II: The Role for NCBs in an Enlarging Eurosystem – a Dynamic Environment

In this session, *Panel I* covered “The ECB and NCBs – Relations within the Eurosystem”. Speakers of the ECB, the Banque de France, De Nederlandsche Bank and the OeNB analyzed the development of the division of responsibilities between the ECB and the NCBs within the Eurosystem.

In his statement, *Roman Schremser* (ECB) provided – based on a comparison of the organisation of cooperation during stage Two of EMU – insights into the decentralised structure of the Eurosystem and underlined the important role of NCBs in the various stages of the ECB decision-making process, namely the contribution to the preparation of decisions via Eurosystem/ESCB committees, decision-making at the level of the ECB Governing Council and the decentralized implementation of these decisions.

Philippe Bonzom (*Banque de France*) sees the decentralized structure of the Eurosystem as a guarantee for a level playing field among individual centers. It takes into account the multicultural and multilingual plurality that is Europe and puts the expertise, credibility and legitimacy of the NCBs at the disposal of the Eurosystem in its entirety. Moreover, NCBs also have responsibilities outside the competence of the Eurosystem, such as banking supervision or representation at the International Monetary Fund (IMF).

Carel C. A. van den Berg (*De Nederlandsche Bank*) emphasized that the system of checks and balances in place between the NCBs and the ECB currently favoured the NCBs, but could become a central subject of debate again. In the future, the Executive Board of the ECB will gradually gain influence in the domain of international financial relations. On the other hand, the role of the ESCB/Eurosystem committees, in which the NCBs play an important role, may also be strengthened. Moreover, the NCBs' responsibilities in addition to their ESCB tasks will continue to gain importance.

Alexandra Schober-Rhomberg (*OeNB*) examined the development of the role that the NCBs play in the Eurosystem and explained that the flexible institutional

structure of the Eurosystem allows for a different division of responsibilities in different business areas. Various organizational models which have developed over time are represented in the different business areas of the Eurosystem. In the decentralized model, a specific function is exercised by all NCBs and is coordinated by the ECB; in the consolidated model, one central bank (an NCB or the ECB) exercises a task; and in the pooling model, a group of NCBs acts on behalf of the other Eurosystem members. Size, expert knowledge, specialization, location and legal as well as economic framework conditions at the national and at the EU level are the main driving factors which determine an NCB's position within the Eurosystem.

During *Panel II*, which was entitled "Decision-Making in Central Bank Systems", speakers from the Freie Universität Berlin, the U.S.A. and Belgium commented on institutional decision-making scenarios for central bank systems.

Helge Berger (Free University Berlin) welcomed the reform of voting modalities in the Governing Council of the ECB. In an international comparison, however, the number of Governing Council members remains high. Therefore, additional reforms could be made if the EU is enlarged further and the euro is introduced in all EU Member States.

D. Nathan Sheets (Federal Reserve System) presented an overview of the institutional setup of the Federal Open Market Committee, the highest decision-making body of the Federal Reserve System (Fed). The correspondence between voting rights and economic strength is not unique to the reformed voting rights model of the Governing Council of the ECB; a voting rights model of this type also applies to the Fed. However, the decentralized nature of the Fed and the decentralized structure of the ESCB/Eurosystem are comparable only up to a point, Nathan Sheets cautioned.

In his speech, *Dominique Servais (Nationale Bank van België/Banque Nationale de Belgique)* pointed out that the Treaty of Nice had decisively limited the adjustment of voting arrangements in the Governing Council of the ECB. The Treaty of Nice did not provide a legal basis for a change in the composition of the Governing Council of the ECB and of the division of responsibilities between the Governing Council and the Executive Board of the ECB. Much rather, it established a system for voting right reform dependent on the sequencing of euro area enlargement. As Servais noted, the voting rights model that the ECB uses combines efficiency with political rationale. The difficulties involved in the ratification process of the EU Constitutional Treaty demonstrate the need for a decentral ESCB/Eurosystem. The efficiency of the Eurosystem and trust in institutions is decisively influenced by the latter's proximity to the people.

The European Integration Process: A Changing Environment for National Central Banks

Welcome Address

Josef Christl

Oesterreichische Nationalbank

Dear Colleagues, Ladies and Gentlemen:

It is a great pleasure to welcome you here at the premises of the Oesterreichische Nationalbank (OeNB) in Vienna. The topic of our workshop, “*The European Integration Process: A Changing Environment for National Central Banks*”, and its timing are, I think, well chosen. We are proud that our EU-workshop, just like the seminar on the *Constitutional Treaty* in 2004, attracts again a distinguished audience and high-level speakers. It brings together almost exactly a 100 central bankers from more than 25 different countries and representatives of the European Commission, governmental bodies and the academia. I think it is a good sign that I see many familiar faces of colleagues that already participated in last year’s workshop. Your positive response indicates that there is need and demand for our activities. It is important to intensify our dialogue and cooperation on institutional and legal issues of European integration and, in particular, of European Central Banks. Our workshop today is one step more into this direction.

Ladies and Gentlemen:

It is needless to say that we are all experiencing demanding times:

- from the ten new Member States that acceded to the EU almost one and a half years ago six already joined the New Exchange Rate Mechanism (ERM II);
- Bulgaria and Romania signed their Accession Treaty with the EU last April with the objective to join in January 2007;
- Croatia and Turkey have just opened accession negotiations with the EU. The outcome of negotiations not only depends on the merits of the individual country but on the absorption capacity of the Union as a whole;

- Macedonia submitted its formal application for EU membership in March 2004 and the European Commission's Opinion on this application is expected for next month.
- Central, Eastern and South Eastern Europe is undergoing different stages of European integration.

Ladies and Gentlemen:

In particular in a period of “constitutional reflection”, it is the euro that today provides a stable anchor for the European Union. The common currency reaches out to areas far beyond Monetary Union and continuously proves to be a catalyst for Europe's integration and economic reforms. The euro has become an important symbol of identity for a modern, dynamic and open Europe.

Central bankers of the European System of Central Banks (ESCB) are spokespersons for the single European currency in their countries. The decentralized character of the ESCB and the Eurosystem allows for the national central banks to play a key role:

- by bridging the communication gap between the supranational and the national level;
- by contributing to stability-oriented monetary and economic policy decision making on both levels and by safeguarding financial stability in our respective country;
- by supplying top economic analyses, compiling high-quality statistical data and by supporting research and development;
- by managing reserve assets with a view to backing the euro in times of crises.
- by operating payment systems, promoting knowledge and understanding among the general public and the decision makers.
- by assuming our responsibilities for payment oversight systems and as actors in a variety of international financial organizations.
- and by supplying the general public and the business community with high-quality cash.

The integration into European decision-making bodies and fora changes a central bank's working methods at all hierarchical levels and in all fields. The deepening of cooperation between the central banks triggers further changes and adjustment requirements. An efficient teamplay between the European Central Bank (ECB) and the respective national banks in the ESCB and the Eurosystem is essential for communicating Europe and for communicating the euro.

With the changing environment in Europe we have refocused, specialized and we have become more flexible. As specialized agencies national central banks enjoy widespread credibility and a very high degree of trust among its citizens. And credibility, trust and stability are much needed elements for a successful integration process in Europe.

Ladies and Gentlemen:

It is against this background that we have tried to set up our workshop. Today's presentations and discussions look at the possible institutional and legal challenges for national central banks at different stages of European integration. Let me now briefly turn to the program:

- The workshop will start with a first-hand assessment of our keynote speaker Professor Padoa-Schioppa. I think there is no need to introduce you Tommaso. Everyone in this room knows your outstanding qualities and curriculum. We are very glad that you have found the time to share your views with us and welcome you in Vienna.

The keynote speech will then be followed by two sessions. Each session is divided into two panels:

- The morning session "Preparing for EU/ESCB Membership" will cover the main institutional and legal challenges for national central banks of selected countries prior to EU and ESCB membership. The fact that the speakers come from countries that currently undergo different stages of European integration, makes it, I think, very interesting to compare experiences. In particular, panel one of session I will focus on the institutional challenges for national central banks prior to EU and ESCB accession. Panel II of session I will then deal with the need for legal adjustments of central bank legislation prior to EU and ESCB membership.
- The afternoon session "The Role of NCBs in an Enlarging Eurosystem – A Dynamic Environment" will, broadly speaking, focus on the functioning and the institutional set up of the Eurosystem. Panel I of session II will deal with the division of labour between the national central banks and the European central bank. And panel II of session II will cover the different forms of decision-making in central bank systems. A topic of relevance in particular for enlarging central bank systems.

Let me remind you that the papers and presentations of our speakers will be published in our workshop proceedings at the beginning of 2006. Again, a warm welcome to all of you and I would like to thank in advance all speakers for their work and their important contributions. Ladies and Gentlemen, I wish you a fruitful, stimulating and successful workshop.

The European Integration Process: A Changing Environment for National Central Banks

Keynote Speech

Tommaso Padoa-Schioppa

Former Member of the Executive Board of the ECB

I am back into a central bank after a few months; a very short period for most of you, a very long one for me. When a big change occurs in ones life, time slows down. This in a way helps me approaching the subject you have suggested to me from a certain distance. I do not think my views on the topics covered by the title have fundamentally changed in the last four or five months. And some of you may have heard some of them already. But maybe the flavour is not exactly the same as if I were still wearing the hat of an active central banker. My address will be about the general title of the workshop “The European Integration Process: A Changing Environment for National Central Banks”, but some of my reflections will be broader, because I think, the environment and even the nature of central banks is changing *irrespective* of the European Union (EU). The EU is a change within an historical trend, which is also affecting your central banks, the Eurosystem and the European Central Bank (ECB). To distinguish between this deeper trend and the specifics of the Eurosystem and the national central banks in the EU is not always easy, but it is necessary to avoid misunderstandings.

The two adjectives that appear in the title are *national* and *central*. They have a clear historical meaning. The National Central Bank, *the* central bank, is a monopolist. It is a bank which has the exclusive right to issue banknotes. The banknotes are the only form of money which is fully protected by the law. Whenever banknotes are used to pay for an obligation, the creditor has no right to refuse them as a means of settlement.

It is called *national* because to issue the currency is a prerogative of the state and the state has been for approximately two centuries the nation state. It used to be a dynastic state and has become based on the idea of the nation only in the course of the 19th century. It is called *central* because of its uniqueness, but also because –

in most cases – the model of the state was a centralised one, where power would be concentrated at the centre. It is a historical development, which has been brought to its highest manifestation by the idea of the Jacobin state, which concentrates all the power. Therefore, central banks are qualified by all these elements in a historical context.

In the EU, however, we have different meanings for these two words.

Now, the central bank of the euro (which we call Eurosystem) is not national, to the extent to which Europe is not seen as a nation. It is not centralised, because it has a federal structure. In the Eurosystem, the word *national* comes to mean something which is almost opposite to what it used to mean for a central bank. In the historical tradition of central banks, *national* means the *whole*, the one and only central bank in the monetary jurisdiction, which coincides with the state. But here in Euroland it refers to a *component* of the central bank of the euro, which is a composite including national central banks. The central bank of the euro (like that of the U.S. dollar) has the name of *system*, not the name *national* or not even the name of a central bank as a singular noun. And system is defined by the dictionary as a set of interrelated components which form a single whole.

To sum up, one could say that the meanings of the two adjectives (national, central) accompanying the noun *bank* are profoundly different in the traditional and in the present context. In the EU environment, the difference in meanings encompasses everything that can be said about the topic.

As I was saying, central banking is changing irrespective of the EU experience. One could even say that the EU experience would not have been possible without a broader change in central banking and in the economic and financial environment. Had the environment remained the one of the time in which the traditional meanings of *national* and *central* developed, probably it would have been impossible to reach a consensus for creating the euro and its central bank.

Thus, let us look at how central banking is changing in this broader sense. Here I would say that it is not just the *environment* of central banking that is experiencing changes. It is central banking itself that is changing in its natural function. And it is changing worldwide, not only in the EU.

Let me first sketch the changes we have seen in the two types of economic regimes that characterise the countries present in this room; centrally planned economies in the Soviet block, on the one hand, and market economies in the West, on the other.

Regarding the former, in communist countries there was no separation between central banking, commercial banking and the state budget. In addition of being the issuer of the currency, the central bank was the agent of the state budget and the single commercial bank of the economy. This was not long ago. The separation between the three entities has been extremely complex and very hard to achieve even conceptually.

Let me note in passing that it would be a mistake to consider integration of central banking, commercial banking and budget functions as only a characteristic of the communist experience. There were elements of it also in Western countries. First a central bank which is not independent, but more or less a branch of the Treasury, tends to be called to exert functions which are ancillary to the budgetary process rather than to the monetary management process. Second, in many countries there are financial institutions, in which the central bank is directly involved. In my own country, for example, some of the large state banks had until recently in their governing bodies a central bank representative. In some countries, even today, we see a lack of distinction between central and commercial banking. For example, the central bank still has private clients, which have their central bank account. The entangling of the three components is most pronounced in centrally planned economies, but it is not their exclusive experience.

If we turn to Western countries, we also see a big change. Central banks used to depend on the Treasury. For many decades, they had little national sovereignty and little institutional independence. On the one side, there was the very strong idea that printing money is a prerogative of the sovereign. On the other side, the basis of the value of money was gold, something that was not really controlled by the sovereign. Some manipulations were possible but up to a limit. Money thus had a very strong international dimension, which lasted until about thirty years ago. Even economists of liberal tradition, were in favour of a strong international dimension of the currency. Today, when an eminent economist like Robert Mundell pleads for a world currency the reaction of central bankers and a large part of the economic profession is to find the idea fancy and unrealistic. But strictly national currencies have existed for very little time. Hayek was in favour of a strong international dimension of currencies and opposed what he called monetary nationalism.

The idea of a strong national role is relatively recent and not fully tested in reality. I have checked how many of the central banks here had the word *national* in their name. A few of them do, and in general these are young central banks: central banks that have emerged from the breaking up of a larger entity like the Austro-Hungarian empire, the Soviet Empire, the Federation of Yugoslavia, the breaking up of Czechoslovakia. The older central banks – in the Netherlands, in the United Kingdom, in France, in Spain and Italy – do not carry this name, because in a way there was no need to emphasize the national character, which was not part of their genetic code.

In Western countries we have experienced an increased nationalisation of central banking due to the floating of exchange rates, the end of the gold standard and the relaxation of any form of international discipline, except for the discipline imposed by the international market. And in the meantime we have seen the tendency towards independence from governmental bodies.

These different trends depend on whether or not a central bank went through the experience of central planning and socialism. But, of course, the two also have elements in common.

There are trends, which affect the *organisation*. In most countries central banks are rapidly closing their branches. The Bank of England has no branches and has less than, I think, 1,500 employees. But, on the other extreme, the Banque de France still has, or had until recently, over 200 branches. De Nederlandsche Bank has cut down on branches and the Bundesbank is rapidly closing its branches.

In the euro area there is a tendency to present such changes as an implication of the euro, because of the bad habit to use Europe as the cause of whatever is unpopular or difficult to implement or communicate at the national level. But the shrinking of the organisation of central banks has nothing to do with the euro. The United Kingdom is not in the euro and it is in the forefront of the change. The shrinking is primarily due to technology, but also has to do with the changing relationship between the central and the commercial banks.

Another trend is the change in the *institutional setting*. The exit of the central bank from the influence of the Treasury is very recent and closely linked to the advent of the euro. Before the Treaty of Maastricht, institutional independence, formalised in the statutes and in the law, existed only in Germany and, to some extent, in the Netherlands. It was completely absent in the United Kingdom, in France and Italy. Statutory independence, the very idea that statutory independence is possible and desirable, was developed conceptually in the same period in which the idea of a single European currency was gaining ground. It was fully implemented in the Treaty of Maastricht. Treasuries would have not relinquished their grasp over the central bank, had it not been as part of the acceptance of independence. And independence of the national banks came as an implication of the Treaty of Maastricht.

The *analytical framework* defining the notion and the tasks of central banks has also evolved, in the sense that increasing focus was placed on the monetary policy function of central banks. This too is a recent phenomenon. Central banks were not created to conduct monetary policy. Indeed even the notion if it was unknown when central banks came into existence. Over time, monetary policy came to be gradually identified as something very specific and increasingly acquired prominence to the point of almost identifying the central bank as the entity in charge of monetary policy. Other crucially important currency-related functions of central banks in the field of financial stability, supervision and payment systems came to be seen as functions of second order.

The Eurosystem is sometimes close to the extreme of viewing itself as an entity only in charge of monetary policy. Some national central bankers occasionally seem to consider that all other tasks of the national central banks have been left unaffected by the advent of the euro and their becoming part of the Eurosystem. I think this is a clear mistake.

The changes I have just mentioned are part of a trend that deeply effects the environment in which national central banks in the euro area operate, but are *not* specifically European trends. It is because of these trends that the creation of a single currency for a group of states (a group which is not itself a state and not even the loosest federal state) was possible. This change is of enormous magnitude for the environment of central banks in the euro area and it triggers a new evolution which is the subject of your workshop.

When the European Economic Community (EEC) started in 1958, we were fully in the world I have described at the beginning of my presentation. Gradually, things evolved. The EU moved from being tied to an external anchor (the U.S. dollar) to an internal anchor (the Deutsche mark), to having its own single currency, the euro. It has moved from the universe of *international* monetary relations, which are typically based on an exchange rate regime, to a typical *national* model, namely one currency – one central bank.

The first of the three regimes lasted for the first 15 years of the EEC from 1958 to the early 1970s; the second for 25 years; the third started in 1999. It is interesting to note that all the three regimes still exist in the EU. Indeed we have countries which are in the first, in the sense of not belonging to any special monetary arrangement of the EU, except the article – which is in the Treaty since 1958 – stating that exchange rate matters are to be treated as *matters of common interest*. The second regime, is the one applying to the currencies belonging to ERM II. The third regime includes the countries participating in the euro area. It is like seeing the rocks belonging to different geological areas still visible within the EU.

Now, what is typically European in all this and what makes the environment special for national central banks? One element is that national central banks are part of a system, which is far more independent than any previous one. I describe it sometimes as a state of solitude rather than one of independence, because there is nobody to be independent from. Within a country (take the United Kingdom or the U.S.A.) the central bank is independent, but there is a government from which it is independent. In the EU there is more than independence. There is absence of a counterpart. In addition the independence is constitutionally based. It is written in a treaty that is virtually impossible to change. Maybe unanimity in an EU with 25 members is a way of locking the statutes even too much.

The Eurosystem is peculiar also because banking supervision remains largely, although not entirely, a prerogative of the subcomponents of the euro area, namely a national prerogative. Hence it is not just like in the United Kingdom, where for the same territory you have two authorities. Here the authorities have jurisdiction over different territories.

Finally, the Eurosystem is an expanding central bank. It gears an economy that is enlarging further.

What I have been saying sets the stage for the different panels of your workshop. The *euro*, the *Eurosystem* and the *changing position of national central banks* mark a development that concluded the creation of a single market. In a way, they represent the endpoint of a process of forty years. However, in another respects, this is only the starting point of another process of change: having become components of the Eurosystem rather than stand alone entities, central banks are bound to transform themselves.

The question of how national central banks will have to evolve is indeed a crucial one, and one full of unknowns. The evolutionary path has to be invented.

We can imagine two extremes. One consist of imagining that the single currency implies, pardon the expression, destroying the national central banks, closing them down and replacing them with an entirely new institution. This is unconceivable in a vast multilingual euro area. It is unconceivable that there could only be the centre. The Bank of England has no branches, but the euro area could never have only an entity at its centre.

At the other extreme, we can imagine that national central banks did not change at all, that they consider the euro as just a small accident that disturbs a little bit their life, but not too much, and that business should continue as usual. It is a caricature, but sometimes one hears statements which are not far from it. This other extreme would also be completely ridiculous. National central banks were what they were on the first of January 1999, when the euro started, precisely because they were stand-alone-entities. They would never have taken the shape they had at that moment, if not because they were *central* and *national* in the sense I have described at the beginning. So it's true almost by definition that a large number of those characteristics are incompatible with being part of a system in the new mode. A number of the characteristics of national central banks are incompatible with the advent of the Eurosystem, but certainly not their existence.

I think that the issue of today's workshop, and a challenge for any central banker in Europe today – whether in Frankfurt or in the capital – is to see what the further evolution and change of central banks will be. I would not say, as the title suggests, only a changing *environment*, but a changing *model* of national central banking.

Thank you.

The Hrvatska Narodna Banka's Experiences in Preparation for the EU/ESCB Membership

Adolf Matejka

Hrvatska Narodna Banka

Abstract

Given its role in a country's economy, it is clear that a national central bank also plays an important role in the process of the country's accession to the European Union (EU). Without prejudice to its primary objective – achieving and maintaining price stability – in performing its activities, the central bank acts in accordance with the principles of the open market economy and free competition. In connection with the choice made by the Republic of Croatia to join the EU, and operating in the dynamic environment, the Hrvatska Narodna Banka (HNB) will face specific challenges and will have to make necessary adjustments on this path. It is important that each future Member State would be well prepared to fulfil political, economic, legal and administrative criteria. At the same time it means that its national central bank should also prepare for the integration process and, within its competences, contribute to the fulfilment of the mentioned criteria. This paper indicates what the activities are that the national central bank may be requested to perform so that it may support the country as appropriately as possible on its way of the accession to the EU.

Key words: The European Union, Hrvatska Narodna Banka (HNB), institutional adjustments

1. Introduction

The accession of a country to the EU implies its compliance with the determined political, economic, legal and administrative criteria. In these aspects the accession countries' national central banks have a special role with respect to their fundamental responsibilities of providing and maintaining low inflation, together with offering support for general economic growth and development. As a rule, by performing their activities, the central banks assist and provide support to their

countries on their way to join the EU, and later on the Economic and Monetary Union (EMU). Although by joining the EMU they lose their monetary sovereignty, they simultaneously gain the right of participating in the creation of the *common* monetary policy of the EMU. Therefore, each central bank is required to make certain adjustments, especially during the accession period because a good preparation means a successful integration.

The Republic of Croatia has entered the negotiations automatically requiring the HNB's participation in the process of joining the EU. The national central bank will be faced with the following challenges: integration into appropriate European bodies, carrying out of the convergence within its competences in economic and legal terms and adequate preparation to join the EMU. The main goal of this paper is to reveal the responsibilities that the HNB should assume, as well as adjustments to be undertaken during the integration process. The course of the very process of the Republic of Croatia's integration into the EU depends on how successful preparations have been made in the changed environment.

This paper is structured in the way that its first part deals with the basic economic indicators for the Republic of Croatia set in the context of all changes and adjustments we are going to encounter with the aim to make successful preparations for joining the EU and – at the later stage – for joining the EMU. Relevant indicators for Croatia have been also computed as the convergence criteria represent key quantitative indicators for the process of harmonization and coming closer to the defined and desirable levels, so called reference values. The referred indicators have been compared with those of the EU countries. Then the paper speaks about the role of the HNB in the changing environment and appropriate adjustments prior to joining the EU: participation in the work on relevant documentation, institutional adjustments and participation in negotiations.

2. Economic Indicators of the Republic of Croatia

2.1 Basic Macroeconomic Indicators

In general, the year 2004 saw positive movements of the basic economic and financial indicators: mainly stable growth, low inflation and decrease of imbalance in foreign trade, together with public debt reaching the stable levels (in spite of the continuing pressure on the expenditures). However, some of the targets were not reached, e.g. the targeted unemployment rate cut, decrease of external debt and less involvement of the public sector in the economy.

Although, generally speaking, it may be said that growth was stable, it is apparent that it slowed down in 2004 (the real growth rate decreased from 4.3% in 2003 to 3.8% in 2004), which was mainly caused by the decrease in investments, or decline in government capital expenditures upon the completion of the investment cycle in road construction. The major contribution to the real growth

resulted from the personal spending and positive movements in foreign trade. The decreased imbalance in foreign trade also led to the significant slowdown in the increase of deficit on the current account of the balance of payment (in 2004 it amounted to 4.5% of GDP). The deficit of the consolidated General Government was higher than planned mainly owing to the significant shortfall in public revenues that had larger impact than the positive effects of public expenditures. The average annual inflation rate, measured by the consumer price index, increased during 2004, but equaled to that of the euro area and is still considered as stable (price stability is first of all based on the maintenance of kuna/euro exchange rate stability in relative terms). However, the decrease in unemployment did not occur according to the defined schedule. The slowdown of the economy during 2004 resulted more or less with the failure in the reaching of progress planned for the decrease in unemployment. Additionally, external debt was increasing at a faster pace than expected and at the end of 2004 its share in the GDP amounted to 82.1% (the main cause of this increase laid in the external borrowing by the banks that was used for financing of the credit expansion in the circumstances of the slow increase of domestic savings). Croatia continued showing solid liquidity in international payments. At the end of 2004 the net international reserves amounted to EUR 5.3 billion enough to cover the 4 monthly imports, and foreign exchange assets of the commercial banks amounted to EUR 7.1 billion.

2.2 Euroization of the Croatian Financial System

In spite of almost 12 years of low inflation, the Republic of Croatia has continued to experience a high level of the currency substitution, i.e. euroization. It is considered that it is the result of persistent high inflation and depreciation of the local currency and negative real interest rates typical for the Croatian pre-independence time. Approximately the three quarters of the bank deposits are held in foreign currencies, out of which the major part is in euro. This situation leaves less room for making monetary policy decisions. In addition, the banks have the majority of their lending linked to the euro or some other foreign currencies. Thus, in this context, the financial system may suffer a lot in case of every major change of the kuna exchange rate, especially in case of a currency depreciation. It is not necessary to emphasize how a massive depreciation might influence the surge of the inflation rate and replacement of the currency risk with credit risk. Namely, residents make their earnings in the local currency kuna, and credits should be repaid in the kuna counter-value of foreign currency, first of all in euro.

Chart 1: A Share of Foreign Exchange Deposits in the Total Bank Deposits

Source: HNB.

2.3 Convergence Criteria

At the start of the negotiations with Croatia on joining the EU it may seem interesting to analyze how the relevant Croatian indicators would comply with the Maastricht criteria as fulfillment of these criteria is a pre-condition for full membership in the EMU, i.e. with the objective of adopting the euro.

The convergence criteria are: price stability, government finance (including the two sub-criteria – budget deficit and public debt), exchange rate stability and long term interest rates. The so called reference values have been determined for every criterion mentioned and they should be satisfied or at least a trend should be developed showing the approach to their “given” levels.

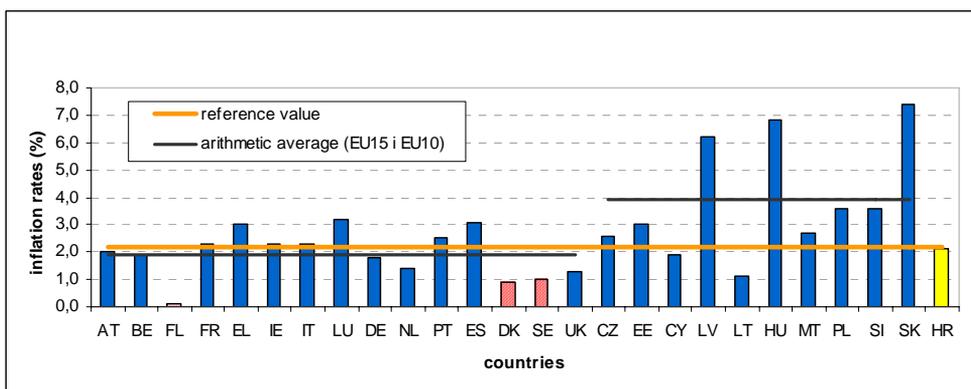
The compliance with these criteria is monitored on monthly, quarterly and annual basis. Although Croatia is not a Member State of the EU, an initial estimate of the economic convergence has been made for Croatia (with notes made on apparent problems or of absence of methodological adjustments). In spite of this a continued monitoring of the mentioned indicators has been performed with the emphasis on the new Member States and the relevant trends developing in them. It is necessary to point out that nearly all the new Member States still have the problems of methodological adjustments for the calculation of their indicators. However, they have been active in making methodological adjustments.

In this connection, the Croatian indicators for the year 2004 have been taken and compared with the relevant indicators of the Member States of the EU to determine the position of Croatia with respect to the fulfillment of the mentioned criteria.

2.3.1 Price Stability

As to the first criterion, the given reference inflation rate on the EU level (all 25 Member States are included) in 2004¹ amounted to 2.2%. In general it should be said that the reference rate in 2004 decreased compared to the rate level of the previous year, when it amounted to 2.5%. By comparing data on the new and the EU-15 Member States, it can be noticed that in 2004 in the new countries an average inflation rate was higher and amounted to 3.9% while in the EU-15 it amounted to 1.9%. In case of Croatia in 2004 the average inflation amounted to 2.1%.

Chart 2: Average Inflation Rates in the EU Member States and Croatia in 2004



Source: Eurostat, State Bureau of Statistics.

Note: Countries, having best results, are represented with hatched graph items.

¹ The average rate of the consumer price index in the three countries having the best inflation performance increased for 1.5 percentage points.

If for this purpose the methodological differences in computation of inflation rate² were not taken into consideration, in the referred period Croatia would comply with the defined criterion of price stability. The compliance with this criterion is of high importance to the HNB, which – as all other central banks – has just a fundamental goal of reaching a high level of price stability.

2.3.2 Government Finance

Under the fiscal criterion the monitoring has been made according to the two sub-criteria: budget deficit (which should not exceed 3% of GDP) and public debt (which should not exceed 60% of GDP). In 2004 even the five “old” countries (Germany, Greece, France, Italy and Great Britain) recorded an excessive deficit and six out of the ten new Member States³ (Cyprus, Czech, Hungary, Malta, Poland and Slovakia) did so as well. According to the EU Treaty, the Member States that have not adopted the euro yet, will neither be subject to undertaking further steps under the excessive deficit procedures, nor to a particularly intensified monitoring of the budget and will not suffer sanctions. However, in the period under consideration none of the EU-15 Member States has been subject to financial sanctions, although some of the countries have exceeded the defined limit. This mainly happened because of the complexity of procedures and time length during which a country having the excessive deficit is expected to improve the government finance (after delivery of an early warning and the conclusion made that the country shows the excessive deficit⁴). If indicators of the budget deficit in

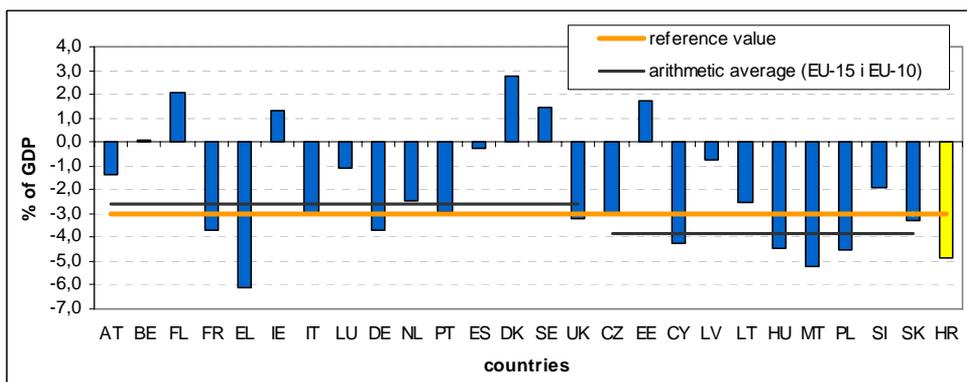
² The average inflation rate in the Republic of Croatia in 2002 was measured by the consumer price index (until then it had been measured by the retail prices index), but computation methodology currently applied differs from the methodology applied by the EU institutions. However, it is important to emphasize that the State Bureau of Statistics calculates the consumer price index simultaneously with the harmonized consumer price index (HICP), which in its major part has been adjusted to the methodology of the Eurostat.

³ As to the state finances criterion, it is important to mention that a few member states have not fully adjusted their methodologies (the information appears in the ECB's Convergence Reports and European Commission Reports) so that the values for the indicators of their success in fulfilling of the criteria should be taken *cum grano salis*. The problem of the (absence) of adjusting methodologies is present in the case of Croatia, too.

⁴ If the European Commission is of the opinion that a country shows an excessive deficit (that is not temporary and is not a result of recession), it shall send its proposal to the Council of Ministers to reach the same conclusion and to make requirement on the country to undertake necessary measures within the given period of time as well as to reduce its budget deficit to a level not higher than 3% of GDP. If contrary, the country shall be subject to sanctions provided for in a form of the interest free deposit that in the end may turn into a fine.

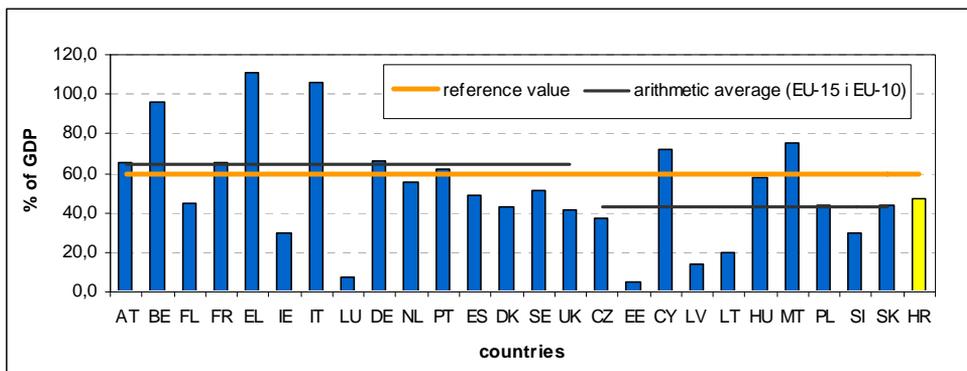
the EU Member States are compared with those computed for the previous year, you can notice an improvement because the average share of the budget deficit in GDP decreased from 2.9% to 2.6%. This improvement was enabled by particular contribution of the new Member States whose average budget deficit decreased from 5.7% in 2003 to 3.9% of GDP in 2004. In 2004, Croatia reported the budget deficit amounting to 4.9% of GDP which means that it failed to comply with the criterion of government finance.

Chart 3a: Government Budget Balance in Terms of GDP in 2004



Source: Eurostat, Ministry of Finance of the Republic of Croatia.

As to the second sub-criterion of the government finance, seven of the EU-15 and two new Member states had a public debt in GDP in 2004 above the reference values (60% of GDP). However, the Maastricht Treaty provides for certain flexibility in the evaluating of this criterion. In case of the countries having exceptionally high public debt in the terms of GDP, it is necessary to monitor the trend of public debt movement, because the indicator will be considered as satisfactory if a share of their debt in GDP decreases and in this way comes closer to the reference values. It is necessary to point out that an average public debt in the European Union in 2004 remained approximately at the same level (63.8% of GDP) as that recorded in the previous year (63.3 GDP). In this same period, the average level of public debt of the new Member States was significantly lower (42.9% of GDP) than that of the EU-15 (64.7% of GDP). Croatia, with public debt amounting to 46.9% of GDP in 2004, complies with this criterion of government finance. In case of this criterion, the absence of adjustments in the methodologies have been present in Croatia as well as in the new EU Member States (it is the result of the differences existing between methodologies of the Government Finance Statistics (GFS) 2001 and the European System of Accounts 1995 (ESA 95)).

Chart 3b: Public Debt in Terms of GDP in 2004

Source: Eurostat, Ministry of Finance of the Republic of Croatia.

Note: For a better comparability the debt of Croatia does not include guaranties issued by the Republic of Croatia.

2.3.3 Exchange Rate Stability

The fulfillment of the exchange rate stability criterion depends on how successfully an EU Member State has participated in the Exchange Rate Mechanism II (ERM II) at least during the two year period without serious tensions on the foreign exchange market nor devaluation or appreciation trends of local currency against euro. It is possible to join ERM II only upon having joined the EU. The past 12 years have seen very slight exchange rate fluctuations of the Croatian currency against euro and it should be added that the current exchange rate regime has been compatible to the ERM II. When time comes, middle exchange rate parity kuna/euro will be mutually determined and it will enable the measuring of how successfully Croatia performs within the ERM II. It will be assessed whether the exchange rate has been close to the central parity or within the margins over the period of the two years. In addition, it is necessary to point out that immediately prior to joining the EU a request for full capital transactions liberalization should be complied with.

2.3.4 Long-Term Interest Rates

The reference value for the long-term interest rates criterion in the euro area in 2004 amounted to 6.3% and thus in comparison with the period analyzed in the latest Convergence Report it declined by 0.1%⁵. It had also declined compared to

⁵ See the ECB Convergence Report 2004; Reference long-term interest rate is computed by adding 2 percentage points to the simple arithmetic mean of long term interest rates that

data for 2003 when it amounted to 6.7%. In the referred period the EU-15 complied with the long term interest rates criterion and nearly all the new EU Member States (only two countries failed to comply with the criterion while a majority of the new Member States developed a trend of falling long term interest rates). It should be stressed that at the moment in case of Croatia there is no representative interest rate that might be considered as reference one⁶ according to the Maastricht requirements. Thus, only for reference reasons in case of Croatia data on the latest 5-year kuna government bonds (issued in March 2005) with 6.75% coupon have been used. Should this interest rate be taken as representative one, Croatia failed to fulfil the long term interest rate criterion.

On the basis of the afore mentioned, a conclusion can be made that in 2004 Croatia failed to comply with the criteria applicable to the budget deficit and long term interest rates. On the other side, it fulfilled the criterion of price stability and other criterion pertaining to the government finance – the criterion of public debt. During its preparation for joining the EU and later EMU Croatia should work on fulfilling all convergence criteria (endeavour on maintenance of already achieved convergence and aim at keeping positive trends) and it also should make additional efforts on methodology adjustments so that calculated indicators would be not only methodologically adjusted but comparable to the relevant indicators of other EU countries.

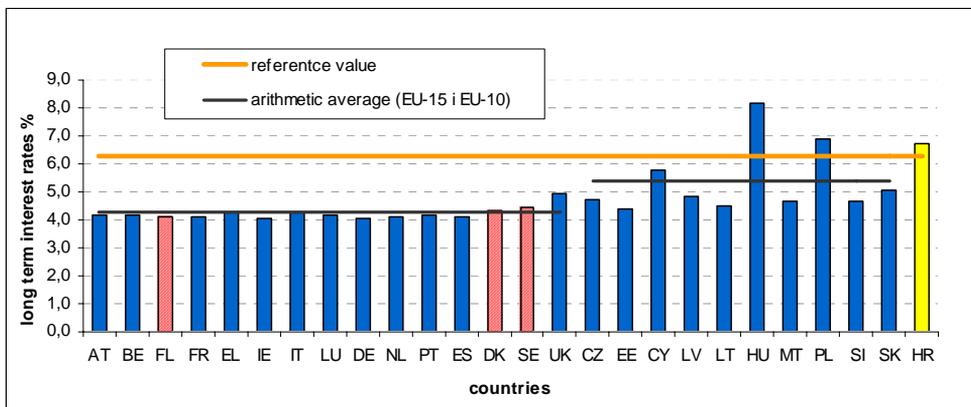
3. The Role of the HNB in the Accession Process

As the central monetary institution of the Republic of Croatia, in the performing of its activities, the HNB supports Croatia on its way to the EU. All these activities may be grouped in the three basic segments of participation by Croatia in the accession process and they are the following: the HNB participates in the work on certain pre-accession documents, carries out necessary institutional adjustments and actively takes part in accession negotiations.

are applicable in the three countries achieving the best compliance with the criterion of inflation.

⁶ The reference long term interest rate is determined on the basis of certain government bonds with their characteristics having been defined in advance so that all data may be mutually comparable. However, as it has been already known, in case of Estonia and Luxembourg other comparable financial instruments have been in use (they will be replaced as soon as more appropriate instruments of comparison are available).

Chart 4: Long Term Interest Rates in the EU Member States and Croatia in 2004



Source: Eurostat, Ministry of Finance of the Republic of Croatia.

Note: Countries having the best inflation performance are represented by hatched graph items.

3.1 Participation in the Work on the Pre-Accession Documents

Through cooperating on EU accession issues with the Ministry of Foreign Affairs and European Integration and Ministry of Finance the HNB has participated in activities related to the preparation of relevant documentation. In summer 2003 it provided answers for the European Commission Questionnaire that had to be filled in and they referred to the following areas: economic criteria, free movement of services, free movement of capital and economic and monetary union. Apart from this the HNB has participated in the work on the National Program for the Integration of the Republic of Croatia into the EU (NPIEU) and Pre-Accession Economic Program (PEP) as well. Following the receipt of the positive Opinion of the European Commission on the Application of Croatia for Membership of the European Union (*Avis*), Croatia was given the status of a candidate country. For the moment the above mentioned Opinion is the most comprehensive document that may be useful at providing the answer to the question of to what extent Croatia fulfils political, economic, legal and administrative criteria in order to be considered as a future EU Member State. In connection with the economic criteria, and providing that it continues to implement the program of reforms for eradication of the rest of weaknesses, Croatia is capable to cope with the pressures of competition and market forces within the EU in the medium term. Therefore, it may be looked at as a state with established market economy (according to the views of the European Commission).

3.2 Institutional Adjustments

With Croatia's joining the EU, the HNB would become a part of the European System of Central Banks and with the adoption of the euro it would be included in the system empowered to create common monetary policy. In cooperation with other EU central banks it should make appropriate preparations for the introduction of the common set of monetary instruments and foreign exchange policy instruments as well, for the introduction of common currency, for common payment system within the EU, for the harmonized statistic data base, appropriate information system, supervision of banks and so on.

In 2004 the government of the Republic of Croatia made its decision on instruments for the adjusting of Croatian legislation to the EU *acquis communautaire* and to the legal acts of the Council of Europe (review of already applicable decision of 2001)⁷. According to that decision, the bodies of the state administration – in their preparation of the (draft) proposal of regulations aimed at harmonizing of the Croatian legislation to the EU *acquis communautaire* and to the legal acts of the Council of Europe – have to complete its instruments for the legislation adjustment. These instruments include *Statement on (draft) proposal of adjusted regulations and Table of Concordance*. The (draft) proposal of regulations, under which the legislation shall be harmonized, has been provided for by the NPIEU and together with the instruments for the harmonization of the legislation shall be submitted to the Ministry of Foreign Affairs and European Integration for the checking and confirming of being harmonized. Thus, the proposals of the laws, falling within the competence of the HNB – The Law on the Hrvatska Narodna Banka, The Banking Law, The Foreign Exchange Act and National Payment System Act – used to be sent to the central banking experts of the European Commission who thereafter provided their relevant opinion.

The banking supervision in the Republic of Croatia falls within the competence of the HNB. Thus, for the reason of as successful integration as possible, in performing its function, the HNB has been faced with specific challenges. Only in the past year, important steps for harmonization have been taken and some of them are as follows:

- reorganization of the Supervision Department aiming at the risk based supervision
- preparations for implementation of a new capital pillar, i.e. Basel II within the national legislation, the form of cooperation with the bodies in charge of supervising foreign banks and vice versa has been agreed (the harmonization of the cooperation form has been already made with the Austrian and Italian bodies, and talks with other countries are under way)

⁷ Decision on measures applicable in the procedure of adjusting the legislation of the Republic of Croatia to the *acquis communautaire* dated October 18, 2001.

- measures for improving currency risk management have been defined, relevant activities have been performed as to the implementation of new accounting standards (IAS and IFRS) and for their inclusion into the national legislation, recommendations have been created for improving management of the IT system aiming at the decrease of the operational risk of the banks and the work at harmonizing legislation on supervision with the EU *acquis communautaire* has been continuously under way⁸

The domestic payment system has been reformed with the aim of achieving better cooperation between institutions that is required for better functioning of the system itself. During the reform procedure the new payments infrastructure has been created followed by the passing of new by-laws and customers' accounts have been transferred to the commercial banks. In 2003, the National Payments Committee was established. Basic responsibilities of this Committee pertain to all forms of the functioning of the payment system in the country (e.g. it helps providing the unique implementation of relevant regulations, stimulates the development of new products and services, it also makes suggestions on guidelines for the development of the local payment system in accordance with the EU directives and accepted international standards). The aforementioned implies that the way has been paved for the development of a more efficient payment system that would bring the satisfaction both to its users and the economy in general. As its structure complies with the international standards, in these terms the payment system is comparable to the EU Member States' payment systems.

In 2004, the HNB issued a decision on the generation and use of the International Bank Account Number (IBAN), which is used in international payments. The implementation of the IBAN enables more efficient performing of payment transactions, relevant automated processing and to decrease the remittance costs and more efficient liquidity management. The full justification of the introduction of the IBAN would be shown at the moment when the full liberalization of capital transactions has been reached, i.e. making of automatic cross-border collections and payments fully enabled. The European Commission for Banking Standards has included the Croatian IBAN into the European Banking Account Numbers Registry.

The legislation framework, covering the field of free movement of capital, has been partly harmonized and this field has been regulated by the Foreign Exchange Act that came into force in June 2003. In accordance with the Stabilization and Association Agreement, Croatia has assumed obligations to liberalize the relevant capital transactions at the gradual pace. At the moment there are still some restrictions left, e.g. non-residents are not allowed to invest in treasury bills of the Ministry of Finance, except for those with their offices or places of residence located in the countries with which the Republic of Croatia has signed a bilateral

⁸ HNB – Supervision Department.

investment promotion and protection agreement. Also, residents may not grant short-term financial loans to non-residents except for within direct investment deals. Residents may not open accounts abroad unless they obtain the HNB approval and they must buy and purchase foreign exchange in domestic banks. In the forthcoming period the HNB shall gradually liberalize the rest of the capital restrictions.

In 2005, the HNB has also introduced a new instrument of monetary policy: open market operations. Like the European Central Bank, it uses there the three basic types of the open market operations: regular operations, fine tuning operations and structural operations. Regular operations are used to increase the system's liquidity. They are conducted every week with a maturity of up to one week through reverse repo operations and are conducted at standard offer auctions. The participants are the banks fulfilling certain general criteria while kuna treasury bills of the Ministry of Finance are taken as acceptable securities.

The changed environment requires new alignments in the terms of the organizational restructuring within the HNB and experience of other countries, i.e. central banks may prove as a useful example. Therefore, even at this stage it is necessary to achieve the close cooperation with the central banks of the EU . In 2004, in the HNB the European Relations Department was established within the International Relations Area with basic responsibilities such as:

- at all times being aware of the globalization processes and standards and the activities of the EU and its institutions
- carrying out the convergence criteria (especially monetary criteria), the EU/EMU policies on the candidate countries and new Member States
- monitoring the activities on the implementation of the Plan for enforcement of the Stabilization and Association Agreement between the Republic of Croatia and the EU
- coordinating activities aimed at the implementing of the EU standards in the Law on the Hrvatska Narodna Banka as well as in other laws whose enforcement falls within the competence of the HNB (i.e. in whose enforcement the HNB takes its part)

Its formal inclusion into the European System of Central Banks implies that the HNB will be a holder of the capital of the European Central Bank. We would like to remind that pursuant to the provisions of the ESCB/ECB Statute and according to the defined key for capital subscription⁹ every national central bank of a EU Member State becomes a holder of the capital of the ECB thereby becoming a (co)owner of the ECB commensurate with its share in the total amount of the

⁹ Capital key is determined on the basis of the number of population of each EU member state as proportion of total EU population and of GDP of each member state in proportion of the total GDP at the EU level (more information thereof in the ESCB/ECB Statute – provisions regulating capital).

subscribed capital¹⁰. Although it would take some time coming up to this stage, it has appeared interesting to explore how much resources the HNB should allocate for the ECB capital subscription. Taking into account some specific conditions, the weightings have been initially determined and assigned to the HNB.

Thus, like all central banks of the Member States – the HNB will assume obligations for subscription and thereupon payment in of the defined amount provided that at first it pays a minimum percentage amount (7%) as to cover the operating costs of the ECB. In addition, when it has satisfied all conditions for adoption of the euro as the national currency, it shall be obligated to pay the rest of the capital up to the subscribed amount and just as well to transfer the amount of foreign reserve assets to the ECB. Starting from the defined criteria for determination of relevant weightings and from the specific assumptions, the weighting to be assigned to Croatia would amount to approximately 0.6%. Still it means that the *subscribed* capital would amount to about EUR 34 million (if the capital percentage, that should be paid by the new Member States at their joining the EU, remained 7%, we should pay about EUR 2.4 million and the rest when euro has been adopted). Taking into consideration the determined weighting, upon Croatia's adoption of the euro, it would be necessary to transfer the foreign reserve assets amounting to about EUR 300 million (the assigned weighting multiplied by EUR 50 billion).

3.3 Active Participation in Negotiations

With being assigned the status of a candidate country for the EU membership in June 2004, the formal preparations have started for the formation of a team for the accession negotiations.

In this respect the required expertise, knowledge of English and negotiation skills have been prerequisites for the nomination of the team members. As a recognized expert in economics the HNB's Governor Deputy has been nominated for one of the deputies of the main negotiator. Experts from the HNB have been also nominated as leaders of the working groups for each area of the negotiations.

The accession negotiations have recently started and it is expected that their duration may be shorter than it was the case with other new Member States. There is a number of reasons for this. Namely, with regard to the delayed start of the integration process, Croatia had more time for the harmonization of its regulations with the EU ones owing to the established set of obligations that Croatia has assumed under the Stabilization and Association Agreement. In addition, Croatia is much more developed than the majority of the new Member States at the moment

¹⁰ Capital is subscribed according to the defined key and at joining EU a defined percentage (7%) of it is paid in. The rest of the amount up to the subscription level shall be paid at the introducing of euro (see also the ESCB/ECB Statute).

of their accession, it has been assigned solid rating that may be even upgraded during the negotiation process and a high euroization degree of the economy in the context of the integration process may also yield positive effects.

4. Conclusion

Joining the EU means that certain alignments should be made by the HNB as a central bank of a (future) EU Member State and in doing so, it would be able to support the Republic of Croatia on its way to the EU. Therefore, the HNB should prepare in time for the forthcoming challenges, which first of all encompass macroeconomic and institutional adjustments. The HNB has consequently continued implementing its monetary policy that falls within its competence with its main goal to reach and maintain low inflation. In the same way the HNB keeps on harmonizing the legislation, falling within its competence, with the EU *acquis communautaire*.

In the process of the EU accession the HNB has still a large part of the work to do in the similar way as the majority of institutions of the Republic of Croatia are expected to do and this will continue even after Croatia's joining the EU. Especially after it has adopted euro, the HNB will become a real actor of the basic euro-system activities. On one side it *de iure* waives its monetary sovereignty, but at the same time *de facto* increases its own influence on the decision-making processes and on its possible participation in all activities related to the common monetary policy of the EU.

References

- Hrvatska Narodna Banka(2005): Annual Report 200, CNB Regular Publication, Zagreb.
- Hrvatska Narodna Banka (2005): *Bulletin No. 100–107, CNB Regular Publication, Zagreb.*
- Hrvatska Narodna Banka (2005): *Macro-prudential Analysis No. 1 – July 2005, CNB Regular Publication, Zagreb.*
- European Central Bank (2004): *Convergence Report 2004*, European Central Bank, Frankfurt.
- European Commission (2004): *European Commission Opinion on the application of Croatia for membership of the European Union*, available at www.mvpei.hr
- Eurostat (2004a): *Long-term Interest Rates for Acceding Countries*, Statistics in Focus – Theme 2-21/2004, available at <http://europa.eu.int/comm/eurostat/>
- Eurostat (2004b): *Euro-Indicators – News Release, September 2004*, available at http://epp.eurostat.cec.eu.int/cache/ITY_PUBLIC/2-23092004-AP/EN/2-23092004-AP-EN.PDF
- Eurostat (2004c): *Harmonised Indices of Consumer Prices (HICPs), A Short Guide for Users*, available at <http://europa.eu.int/comm/eurostat/>
- Eurostat (2004d): *Interest Rates: Maastricht Criteria Bond Yields*, Eurostat Metadata in SDDS format: Summary Methodology, available at <http://europa.eu.int/comm/eurostat/>
- Eurostat (2004e): *Long-term Interest Rates*, Eurostat Metadata in SDDS format: Base Page, available at <http://europa.eu.int/comm/eurostat/>
- Faulend, M., Lončarek, D., Curavić, I. and A. Šabić (2005): *EU Criteria with Special Emphasis on the Economic Convergence Criteria – Where is Croatia?*, CNB Surveys, Zagreb.
- Nestić, D (2005): *Price Level Convergence: Croatia, Transition Countries and the EU*, CNB Working Papers, W-13, Hrvatska Narodna Banka, Zagreb.
- State Bureau of Statistics (2005): *Publications*, available at www.dzs.hr
- Ministry of Finance of the Republic of Croatia (2005): *Publications*, available at www.mfin.hr

Legal Sources Used

Agreement between the European Central Bank and the national central banks of the Member states outside the euro area laying down the operating procedures for an exchange mechanism in stage three of EMU, Official Journal of the European Communities C/345/6.

Budget Act, official gazette Narodne novine No. 96/2003.

Council Regulation (EC) No. 2494/95 of 23 October 1995 concerning harmonised indices of consumer prices

Council Regulation (EC) No. 3605/93 of 22 November 1993 on the application of the Protocol on the excessive deficit procedure annexed to the Treaty establishing the European Community.

Protocol on the Statute of the European System of Central Banks and of the European Central Bank (unofficial consolidated version), Official Journal L 236, 23.9.2003. p.33.

Resolution of the European Council on the establishment of an exchange rate mechanism in the third stage of economic and monetary union, Official Journal C 236, 2/8/1997.

Treaty on European Union (consolidated text), Official Journal C 325, 24/12/2002.

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

Cristian Popa¹

Banca Națională a României

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.

References

European Commission, 1998 – Commission Report COM(98) 702 final (not published in the Official Journal).

European Commission, 1999 – Commission Report COM(1999) 510 final (not published in the Official Journal).

Banca Națională a României, 1997 – Annual Report, Bucharest.

Popa, Cristian, 1998 – Nominal-Real Tradeoffs and the Effects of Monetary Policy: The Romanian Experience, Working Paper no. 244, William Davidson Institute, University of Michigan School of Business Administration, Ann Arbor, MI, December.

Popa, Cristian, 2004 – Recent Developments in the Romanian Banking System, BNR working breakfast presentation on the occasion of the EBRD AGM, London, April 18, <http://www.bnro.ro/En/Prez/E20040418vice.pdf>

Eesti Pank in the European Integration Process

Martin Põder

Eesti Pank

For Estonia, active striving to the European Union (EU) started shortly after regaining independence in 1991. The Accession Agreement was signed in 1995 and in the same year a formal membership bid was put on the table. In 1995, the target of full membership “only” in 2002-2003 seemed like a very long time away, but looking back at the past ten years, one feels that the time has been flying. It has been very interesting, fast-paced development for Estonia, and Eesti Pank – the national central bank – has played an active and important role in the European integration process. With every new goal there have been new, higher challenges. This paper describes how Eesti Pank has met these challenges during 1995–2005.

1. Getting Ready for EU Membership

EU membership – “restoration of Estonia’s place in Europe” – was a clear goal when Estonia regained its independence from the Soviet Union occupation. When the Accession Agreement was signed in 1995, Eesti Pank became an active participant in various EU committees and in the domestic coordination. In 1996, the Government created the Council of Senior Civil Servants and the central bank was also represented there at high level. This ensured good information flow and the ability to influence preparations in areas close to the central bank’s heart: economic policy issues, free movement of capital, financial services. The Estonian Government delegation for the EU accession negotiations was formed in 1997 (the negotiations started formally in March 1998) and Eesti Pank participated in the negotiations on four chapters: Free movement of services, Free movement of capital, Economic and Monetary Union (EMU), and Institutions. Owing to the liberal economic policy, these were not difficult chapters to negotiate for Estonia. However, there was a lot of EU legislation to be analysed and then implemented in Estonian law. Eesti Pank, even though small in comparison to other central banks in Europe, was well resourced and staffed when compared to several key ministries and therefore the various reports, draft legislation and economic analyses were warmly welcomed by the government institutions.

It is interesting to note that while some EU Commission officials openly suggested that a country should not worry too much about fulfilling the Maastricht

criteria before entering the EU, and for example having a budget deficit larger than 3% would also be acceptable, the Estonian Government decided early on against such “handicap”. Obviously, with the currency board arrangement in place it was most important that the fiscal policy remained conservative and Eesti Pank’s advice on this issue was generally appreciated and heard.

Change in legislation was one of the most visible elements of the EU accession process and Eesti Pank played its part there. The revision of the Central Bank Act was naturally of special interest. The key goal in this process was to maintain the independence of Eesti Pank – a somewhat tricky task with the Parliament handling dozens of new laws in parallel in order to harmonise the legislation with the Community law. Moreover, major changes in legislation rose questions about how to maintain quality in such a fast implementation process, how to ensure quality of translation, and how to contain “over-eagerness” to adopt everything without first trying to adjust directives to suit better the Estonian circumstances. The first years in the EU have shown that the preparations for the EU accession were of high quality and both the legal bases as well as the implementing agencies were generally well prepared for the membership in the Union.

2. Participation in the EU Decision-Making Process

When Estonia became EU member in May 2004, the representatives of Eesti Pank and the Government had been participating for about 9–12 months in various EU committees, councils and working groups as observers. Membership of the ESCB brought about participation in the major share of such committees and working groups, but the representatives of Eesti Pank take part also in the Council and Commission committees and working groups. Altogether about 70 committees and working groups entailed a great increase in the workload for bank staff, whereas the number of employees (around 240) has not grown. The key people involved – the Governor and Deputy Governors, heads of departments and units, and key specialists – have been able to cope with new tasks very well, but it has taken some time to adjust. And we are well aware that with membership in the euro area this workload will increase even further. In Eesti Pank we have seen a clear increase in knowledge and understanding of relevant issues, which, in turn, has facilitated more effective participation in the committees and working groups. Overall, the EU membership has raised the requirements for analysis and know-how, because many topics have been new or only relatively little known.

A key to successful participation in the EU decision-making process is good preparation and coordination. While all the departments are responsible for their own areas, the Department of International and External Relations has the role of the coordinator. Among its tasks is the preparation of the management’s EU coordination meetings, which take place every two weeks. At those meetings the management takes stock of the bank’s work in Europe and discusses the main

priorities and positions for the forthcoming meetings. Since 2001, Eesti Pank has also assigned a representative to the Estonian mission to the EU, whose main areas of responsibility are the Economy and Finance Council (ECOFIN), financial services and issues related to the euro changeover preparations.

Eesti Pank participates in the Government's Coordination Committee (successor of the Council of Senior Civil Servants which played a key role in preparing for EU membership) that coordinates the positions for all Council meetings before the Cabinet formally adopts them. For informal discussion and coordination of economic policy issues, Eesti Pank chairs a special high-level meeting of Ministries of Finance and Economy as well as the representatives of the Prime Minister and President's office. This forum allows to discuss potential policy responses to various developments before they are made public, to exchange views on the main developments and to draft common positions on key economic policy issues in Europe, such as the reform of the Stability and Growth Pact.

3. Getting Ready for the Euro Area

Fast accession to the euro area is a natural choice for Estonia, as our currency has been pegged to the German mark and later on to the euro for more than 14 years. With a prudent fiscal policy and the economy growing well, the criteria for entry should not pose any major problems for Estonia. However, there have been some "Estonia-specific" challenges already prior to the EU accession – for example, the discussion about the compatibility of currency boards with the New Exchange Rate Mechanism (ERM II) (we know this debate ended with the decision that a double regime shift prior to the adoption of the euro was neither required nor advisable, and thus Estonia joined the ERM II with a standard fluctuation band and with maintaining the currency board arrangement as a unilateral commitment). Estonian Government's tiny debt posed a different problem – lack of a comparable indicator for the interest rate criterion. Fortunately, the idea that in order to meet the formal Maastricht criteria the Government should issue a meaningless (and unnecessary) 10-year bond has been rejected. A few years before the EU accession there was also a debate in Estonia about unilateral euroisation, but upon the advice of Eesti Pank the Government decided that the adoption of the single currency should fully respect the EU rules.

The convergence reports of 2004 were quite positive about Estonia's euro aspirations and the Government and Eesti Pank have maintained January 1, 2007 as the target date for the changeover. The surge in oil prices has affected the inflation in recent months, but despite a challenging situation the Government remains committed to the goal.

Obviously, the changeover entails a lot of practical preparations. The Government established a Changeover Committee in January 2005 and several working groups to lead the practical work. Eesti Pank is a member of the

Changeover Committee, chairs the Credit Institutions working group, and participates actively in most others as well. A key area is naturally communication. As the opinion polls show, one of the main concerns of the general public is the possible rise in prices. Even though the statistics do not reveal notable price increases stemming from the introduction of the new currency, this perception is very strong also in the present euro area and gives a lot of food for the euro sceptics in Estonia.

4. Challenges on the Domestic Front

When times are good as they have been in Estonia – with strong and stable economic growth without setbacks since the Russian crisis in 1998 – the role of the central bank becomes less visible to the general public. Although the EU accession brought along new tasks and the membership in the Eurosystem will add to that, there are questions about the bank's future role. Some ask quite bluntly – why do we need a central bank when we have the euro and the European Central Bank (ECB)? Therefore, one of the challenges ahead is better communication of the bank's mandate and role in the European System of Central Banks (ESCB). One of the points made is that unlike the countries with floating exchange rate regimes, Estonia will not have to give up independent monetary policy. On the contrary, in the Eurosystem Eesti Pank will take part in the decision-making on issues that are already affecting Estonian economic environment but where we have no say at the moment.

One of the questions asked is whether the current economic success and the supporting conservative policies will continue. Estonian politicians who have generally supported tight fiscal policy are quick to point out the current state of fiscal affairs in many euro area economies. It would probably be tempting to be less stringent once inside “the club” and thus the central bank will need to stay alert and vocal if this becomes the case.

Institutional Changes in the European Integration Process – the OeNB’s Experience¹

Isabella Lindner

Sandra Dvorsky

Oesterreichische Nationalbank

Abstract

This study discusses the developments which had and have an institutional, legal and functional effect on the Oesterreichische Nationalbank (OeNB) during Austria’s integration process into and within the European Union and the ESCB/eurosystem. The run-up to and the first stage of Austria’s EU membership (1995 to 1998) brought about three major challenges for the OeNB: integration into European bodies and fora, achievement of economic and legal convergence and preparation for monetary union. Once Stage Three of Economic and Monetary Union (EMU) began on January 1, 1999, the OeNB became a member of the European System of Central Banks (ESCB) and the Eurosystem, which went hand in hand with fundamental changes in the structure of the OeNB’s tasks in almost all business areas. The introduction of euro banknotes and coins on January 1, 2002, an undertaking requiring an effective communication policy coupled with sophisticated cash logistics, posed a formidable challenge. Now, several years into European integration, the OeNB has succeeded in maintaining its role as a think tank for economic policy in Austria and as an interface between the single monetary policy and the national economic policies.

1. Introduction

Despite the conclusion of the EEA (European Economic Area), which preempted most of the EU-accession negotiations, it took Austria six years to complete the accession process. With regard to monetary integration, Stage Two of Economic and Monetary Union (EMU) had already been in progress for one year, when

¹ This paper draws heavily on an article published in June 2005 (Dvorsky and Lindner, 2005).

Austria acceded to the EU on January 1, 1995. But once Stage Three of EMU was launched on January 1, 1999, Austria was among the founding 11 Member States of the euro area that from then on determined the single monetary policy. This step implied sweeping changes for the OeNB, which became an integral part of the European System of Central Banks (ESCB).²

Compared to the economic aspects of EU and EMU accession, the institutional change that takes place is very often neglected in analysis. As it is, the institutional set up of the EU and the ESCB is binding for all member states and national central banks (NCBs) without leeway to circumvention. However, its impact can be significant and varies depending on the general convergence a country has already achieved. While Austria was economically and legally convergent when it joined the EU and EMU, significant institutional change in economic policy institutions such as the OeNB is typically a longer-term process, which had to be launched even before Austria's EU accession and is still ongoing in certain areas. This paper discusses the integration developments which have had an institutional, legal and functional effect on the OeNB and describes the OeNB's response to the challenges associated with these rapidly changing framework conditions. The paper runs through the OeNB's – and to a certain extent Austria's – experience in a chronological order.

2. Run up to and EU Membership: 1995 to 1998

Austria chose economic convergence with its main trading partner, specifically Germany, at a time when the economic prerequisites of the Maastricht Treaty did not yet exist. Thus when Austria joined the EU participation in the European Monetary System (EMS) and its Exchange Rate Mechanism (ERM) was the logical next step. As the OeNB had already successfully pursued stability-oriented goals since the 1970s, participating in EMU constituted a continued development of this stability policy. Therefore, from the outset the OeNB was clearly committed to ensuring that Austria would take part in the monetary union as early as possible. ERM membership as such did not constitute a significant change; significant changes were only introduced as soon as preparation for monetary union began.

This seamless transition to the single monetary policy brought about three major challenges for the OeNB, specifically its integration into European bodies and fora, the achievement of economic and legal convergence and preparation for monetary union, in particular the irrevocable fixing of exchange rates. Here the OeNB's and Austria's experience shows that economic, legal and institutional challenges of convergence are best met by a longer-term approach.

² See section 3 for a definition of the term "ESCB".

2.1 The OeNB Participates Actively in European Bodies and Fora

Austria's accession to the EU afforded the OeNB equal rights to participate³ in the EU's bodies and fora and in the European Monetary Institute (EMI) founded in 1994. This meant that the OeNB participated actively in the preparations for monetary union from the very beginning. The most important objectives pursued by the OeNB were continuing a stability-oriented monetary policy, strengthening the Austrian financial market and implementing the principle of subsidiarity in the ESCB.

In order to prepare early for effective and competent participation in EU institutions, the OeNB had already set up a representative office in Brussels in 1988. This office greatly facilitated and accelerated the exchange of information between the OeNB and the EU. Since 1995, the governor of the OeNB has attended the semiannual informal Ecofin Council meetings, which deal with strategically significant fiscal and economic policy issues in the EU. In addition, OeNB representatives became members of the EU's Monetary Committee,⁴ the Economic Policy Committee and the Banking Advisory Committee⁵, which are responsible for preparing the Ecofin ministers' meetings in their respective areas of expertise.

Since the signing of the Maastricht Treaty, the OeNB had already made intensive preparations for its potential role in the ESCB and maintained close relations with the other central banks in the EU. As a result, the OeNB was accepted as a full member of the EMI without difficulties from the very beginning. Owing to the high credibility of Austria's economic and monetary policies, the OeNB quickly managed to make itself heard within the EMI in the process of designing the single monetary policy. The EMI undertook preparatory work for implementing Stage Three of EMU, which included the introduction of a common European currency, and geared up for the establishment and development of the European Central Bank (ECB) and the ESCB. In cooperation with the (then) 14 other EU central banks, the OeNB prepared for a common set of monetary and foreign exchange policy instruments, a single currency, an EU-wide payment system, a harmonized statistical data basis, a comprehensive information system and banking supervision (OeNB, 1995, p. 52). In order to tackle the abundance of different tasks and to coordinate the activities of the national central banks a committee structure was devised for the work of the EMI. The OeNB was represented at all hierarchical levels of this structure. The body with the highest decision-making power was the EMI Council, which consisted of the EMI's

³ After the signing of the Accession Treaty in March 1994, the OeNB had been granted observer status in European bodies and fora.

⁴ Known as Economic and Financial Committee (EFC) from January 1, 1999, onward.

⁵ Now the European Banking Committee.

president as well as the 15 NCB governors, including the governor of the OeNB.⁶ The work of the EMI Council was supported by the Committee of Alternates, which consisted of senior representatives of the EU central banks and contributed to preparing the meetings of the EMI Council. In addition, a Financial Committee was in charge of the EMI's annual budget and annual accounts, as well as three subcommittees and six working groups.⁷ The active participation of OeNB representatives within the committee structure of the EMI posed new challenges in terms of organization and human resources. For example, as early as 1996 more than 70 experts from the OeNB prepared a total of 385 meetings in Frankfurt and represented the OeNB's interests in various committees, subcommittees and working groups (OeNB, 1997, p. 42). In 2003 the numbers had risen to 135 experts from the OeNB preparing and participating in 603 meetings within the ESCB/eurosystem in Frankfurt (Intellectual Capital Report, 2004b, p. 19).

As an institution which had primarily dealt with national duties in the past, the OeNB was faced with the task of adapting its everyday operations to the European environment. Constant benchmarking against other NCBs generated clearly increasing pressure to invest in human capital with a view to optimizing the output. Overall, the OeNB's regular participation in the internationally attended meetings of these committees and subgroups brought about a large number of new tasks in the field of intercultural management, for example in the formation of political and tactical coalitions when negotiating in an international context. The intense decision making at the European level basically sparked a race for brilliant arguments. This development gave rise to one very positive insight at the OeNB: Even representatives of a relatively small country can have a considerable impact on EU decision making (Tumpel-Gugerell, 2002, p. 12).

2.2 The OeNB Supports Austria's Path to Economic and Legal Convergence

Since the early 1970s, Austria's monetary policy had already enjoyed success in its orientation toward stability goals and macroeconomic fundamentals, which largely concurred with the convergence criteria set forth in the Maastricht Treaty. From the OeNB's perspective, it was crucial to fulfill the convergence criteria sustainably and in compliance with the Treaty.⁸ The OeNB therefore supported the Austrian

⁶ The EMI Council convened ten times per year. The current chair of the EU Council and one member of the European Commission also had the right to participate in EMI Council meetings, but without voting rights (EMI, 1997, pp. 32–36).

⁷ For a detailed description of the EMI's committee structure as well as the focuses of the subcommittees and working groups, see OeNB, 1996, pp. 39–41, OeNB, 1997, pp. 42–45 and OeNB, 1998a, pp. 22–26.

⁸ Treaty on European Union, February 7, 1992.

government's efforts to ensure conditions which were conducive to stability. On January 9, 1995, just a few days after its entry into the EU, Austria joined the ERM within the EMS, thus taking an important step toward meeting the economic convergence criteria.⁹

As one of Austria's main economic policymakers and a declared proponent of monetary integration in Europe, the OeNB, with its experts, made a substantial contribution to the process of economic convergence. For example, OeNB representatives were actively involved in the committee work on drawing up the EMI's decisive 1998 Convergence Report, which required extensive preparatory work and expertise in the fields of statistics, economics and law on the OeNB's part in order to represent Austria's interests in the relevant committees. At the request of the Austrian Federal Ministry of Finance, the OeNB also carried out a separate assessment of convergence in the EU and presented its own convergence report in 1998 (OeNB, 1998a, pp. 20–24).

In November 1996, the EMI had already published its first convergence report, which, in addition to providing an initial assessment of economic convergence, identified necessary adaptations in the statutes of the individual NCBs. A number of adaptations to the relevant Austrian legislation¹⁰ were also suggested (EMI, 1996, p. 134). The requirements of legal convergence in EMU probably imposed the most substantial changes on the OeNB as an institution and on its relationship with Government and Parliament. In order to fulfill the requirements of the Treaty and the Statute of the ESCB¹¹ an amendment introducing substantial changes to the Federal Act on the Oesterreichische Nationalbank was put into effect in 1998.¹² In this context, the OeNB's monetary policy objectives¹³ were reformulated, and its monetary policy instruments were completely adapted to comply with the requirements of the Statute of the ESCB. This was done in order to equip the OeNB with all of the powers necessary to carry out monetary policy operations

⁹ The effects which Austria's ERM participation had on the OeNB are discussed in OeNB, 1996, pp. 28–29.

¹⁰ Federal Act on the Oesterreichische Nationalbank (Nationalbankgesetz – NBG) 1984, BGBl. (Federal Law Gazette) No. 50/1984, as amended by BGBl. No. 532/1993.

¹¹ Protocol (No. 18) on the Statute of the European System of Central Banks and of the European Central Bank, 1992, referred to as the “Statute of the ESCB” in this study.

¹² With regard to the time at which this amendment went into effect, it is necessary to note that the amendment contains various effective dates due to different requirements under EU law and Austrian law: The regulations ensuring the independence of the OeNB took effect on May 3, 1998, when the resolution on the participation of Austria in the monetary union was taken. Those provisions which secure the full administration of ESCB duties and powers by the OeNB went into effect on January 1, 1999 (start of Austria's participation in Stage Three of EMU). For more information, see also OeNB, 1998a, p. 57.

¹³ The monetary policy objectives were adapted to Article 105 paragraphs 1 and 2 of the Treaty.

once monetary union began (OeNB, 1998a, p. 57). Moreover, the amendment to the Federal Act on the Oesterreichische Nationalbank reinforced the independence of the OeNB, set a five-year term of office for all members of the Governing Board and defined possible grounds for dismissal in line with the Statute of the ESCB. Instead of the provisions previously in force, the provisions prohibiting the monetary financing of public deficits pursuant to Article 101 of the Treaty were adopted. In order to implement the transfer of monetary policy powers to the Governing Council of the ECB, it was also necessary to amend the mandate of OeNB bodies, which subsequently led to fundamental organizational changes in the OeNB as an enterprise: In particular, the OeNB's General Council, following the monetary policy transfer, was invested with functions similar to those of a publicly held company's supervisory board. Moreover, the number of members in the Governing Board was reduced from the previous maximum of six to four, including the governor, vice governor and two other members. Along with the changes in general conditions due to the start of monetary union, this reduction called for far-reaching restructuring measures within the OeNB, which were implemented step by step between 1997 and 1999. A comparison of the OeNB's organizational charts reveals that the six previously existing units were merged into four departments: Central Bank Policy; Economics and Financial Markets; Money, Payment Systems and Information Technology; as well as Investment Policy and Internal Services (OeNB, 1997, pp. 12–13 and OeNB, 1999, pp. 12–13).

On March 25, 1998, the EMI as well as the European Commission published their convergence reports, in which Austria was given a favorable assessment by both institutions (EMI, 1998, pp. 199–203 and p. 303; European Commission, 1998, p. 41 and pp. 55–56). On May 3, 1998, the European Council, meeting in the composition of the Heads of State or Government, finally decided that Austria and ten other EU Member States had fulfilled all of the requirements for the introduction of a single currency. As of June 1, 1998, the President, Vice President and four other members of the ECB's Executive Board were appointed, thus the ECB was formally established.¹⁴

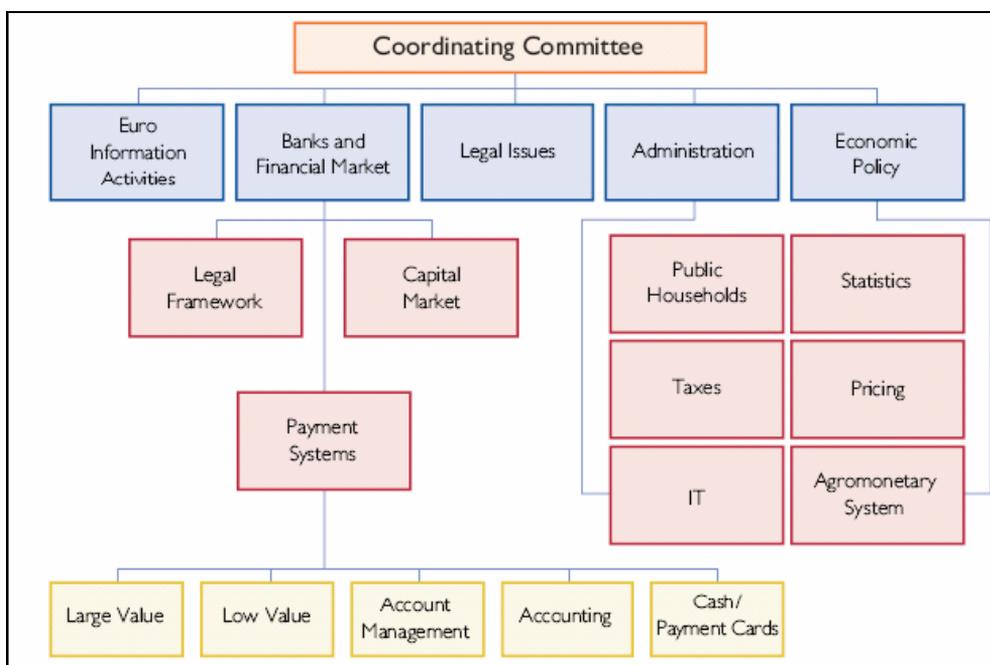
2.3 The OeNB Prepares for the Start of Monetary Union

In December 1995, the European Council in Madrid had approved a scenario for the transition to the euro as the European common currency. The transition was divided into stages in order to create reliable guidelines for the private sector with regard to which measures would be taken by the authorities at what time (European Commission, 2005, p. 42). Details and implementation of changeover arrangements were left to the Member States and differed from country to country.

¹⁴ This meant that the EMI had completed its tasks and was thus dissolved as of June 1, 1998.

In Austria, the OeNB was heavily involved in the design and implementation of the National Master Plan, i.e. in the general preparations for the start of monetary union in Austria. Together with the Austrian Federal Ministry of Finance, the OeNB held the chair of a coordinating committee within the EMU task force established in June 1996 for the purpose of implementing measures for the transition to the euro within Austria. Between 1996 and 2002 this coordinating committee steered the activities of five working groups, which covered the areas of public information, banks and financial markets, legal affairs, administration and economic policy. In addition to Austrian federal ministries and the OeNB, the financial sector, social partners, economic research institutions as well as Austrian provinces and municipalities were also represented in the working groups (chart below).

Chart 1: Austria's Changeover Committee: Coordinating Committee and Working Groups



Source: OeNB.

The main tasks of these working groups were to coordinate domestic preparatory measures for Austria's accession to the monetary union and to provide decision support to the government in the fields of general policy, economic policy and law. Furthermore, the OeNB also participated largely in the Federal Government's "Euro-Initiative", a grassroots public relations effort to keep Austrians informed on the political and economic importance of the euro introduction, and the when and the how of the cash change over. This set up proved to be very efficient in coping with the entire range of issues involved in the changeover (Gruber et al., 2005, p. 56).

On the basis of the Madrid overall transition plan, the EMI's master plan was revised and also used as a model for the OeNB's own master plan for the introduction of the euro (OeNB, 1998b). This OeNB master plan described the process of introducing the euro in great detail. In the course of this large-scale project, nearly 70 subprojects were coordinated and human resources totaling some 350 personnel years were deployed (OeNB, 1998b, p. 2).

In order to ensure the actual participation of Austria in the monetary union, the OeNB had to meet the organizational, technical and operational prerequisites for ESCB membership by the end of 1998: For example, the monetary policy instruments used in Austria were rapidly harmonized with those of the future eurosystem. Likewise, the OeNB's statistical framework was adapted, and a number of operational and technical adaptations were required, for instance in the areas of payment and IT systems. Moreover, it was necessary to prepare for the production and issue of euro banknotes. At the same time, organizational processes were streamlined and modernized, and business processes were networked within the eurosystem (OeNB, 2000b, pp. 7–18). These varied measures (developed within the EMI's committee structure and coordinated internationally) affected all of the OeNB's business areas. In order to meet the increased qualitative demands on its staff, the OeNB quickly launched a training program on EU topics and took these changing demands into consideration in its recruitment policies. The Economic Studies Division was established within the OeNB's Economic Analysis and Research Section, and the number of economists and statisticians grew in line with new qualitative demands in the fields of research, forecasting and statistical reporting. The structure of the OeNB as a group of companies also saw fundamental changes in anticipation of Austria's participation in the monetary union, mainly in the form of further horizontal diversification in money production due to the OeNB's acquisition of AUSTRIA CARD-Plastikkarten und Ausweissysteme Gesellschaft m.b.H. The OeNB also reinforced its position in the payments sector by taking a stake in Austrian Payment Systems Services GmbH (APSS). Furthermore, the OeNB's securities printing office was spun off as a new subsidiary called OeBS (Oesterreichische Banknoten- und Sicherheitsdruck GmbH, OeNB, 2000b, pp. 17–18).

3. Second Stage of EU Membership: 1999 and Beyond

The irrevocable fixing of exchange rates as of January 1, 1999, brought about a fundamental transformation of overall monetary and economic policy conditions for the OeNB. By transferring formal sovereignty over monetary policy to the ECB, the Member States which adopted the euro saw a new distribution of roles between the ECB and the individual central banks in the EU. The OeNB's institutional and functional areas of activity thus changed substantially. However, the *de iure* transfer of monetary sovereignty *de facto* increased the OeNB's influence on decision processes related to European monetary and central bank policies as compared to before (Hochreiter, 2000, p. 308).

3.1 The OeNB Joins the ESCB and the Eurosystem

With the start of Stage Three of EMU, the OeNB became an integral part of the ESCB, which comprises the ECB and the NCBs of all EU Member States, and of the eurosystem, which consists of the ECB and the NCBs of the Member States which have adopted the euro.¹⁵

The governor of the OeNB is a voting member of the ECB's Governing Council, the body which is responsible for monetary policy decisions and consists of the six members of the ECB's Executive Board and the (currently 12) NCB governors in the eurosystem (ECB, 1999, pp. 55–56). Participating in the eurosystem has increased the OeNB's influence in that the governor of a relatively small central bank can now participate actively in decisions on the single monetary policy on the basis of the “one member, one vote” principle.¹⁶ In this context, however, it is necessary to emphasize the fact that in monetary policy decisions and in the fulfillment of the ESCB's other duties, the governor of the OeNB – like all other members of the ECB's Governing Council – acts completely independently and in the interest of the euro area as a whole, as he was appointed for this office in a personal capacity. The governor of the OeNB is also a member of the General

¹⁵ To enhance transparency and enable the public to grasp more easily the complex structure of the ESCB more transparent and comprehensible, the ECB's Governing Council decided to adopt the term “Eurosystem” for that part of the ESCB which includes the ECB and the NCBs of the 12 Member States currently participating in Stage Three of EMU (OeNB 2000a, p. 16). Since May 1, 2004, the ESCB has consisted of 25 NCBs and the ECB.

¹⁶ In the light of the expected enlargement of the euro area and the resulting increase in the number of members in the ECB Governing Council, voting modalities were amended in March 2003 to provide for a rotation scheme based on three groups of countries. In this context, the principle of “one member, one vote” was generally upheld (for details see Dvorsky and Lindner, 2003).

Council, which includes the President and Vice-President of the ECB as well as the NCB governors of all 25 EU Member States.¹⁷

The Governing Council of the ECB generally meets at 14-day intervals. In addition to monetary policy, the topics discussed include the entire spectrum of issues related to central banking. Therefore, the relevant decisions of the ECB Governing Council require well-founded expert analyses from the ECB as well as the NCBs. This is an essential prerequisite for efficient decision making. The EMI's committee structure was retained and adapted in order to ensure the regular exchange of views among experts at the ECB and the NCBs and to prepare the meetings of the ECB's Governing Council and General Council. In practice, the work of the committees is highly important because many topics cannot be discussed in sufficient detail in the Governing Council and General Council due to their complexity and scope (Bartik et al., 2004, pp. 31–34). Since the start of Stage Three of EMU, the number of committees and subordinate groups has continued to rise, so that the committee structure currently consists of 14 committees and 111 subordinate groups in total (subcommittees, working groups and task forces; Bartik et al., 2004, p. 66). Participating in the committees and subordinate groups has brought about fundamental changes in the organizational and professional demands placed on OeNB experts: The topics discussed in the various committees and subordinate groups concern nearly all core business areas and hierarchical levels at the OeNB, and the working language is invariably English. On average, each committee convenes ten times per year for one to two days, and the meetings are nearly always held in Frankfurt. The OeNB sends a total of 26 representatives to the 14 committees and 109 representatives to the respective subordinate groups¹⁸ (Bartik et al., 2004, p. 69).

3.2 The OeNB as an Operative Entity of the ESCB

The ESCB/eurosystem is basically structured as a federal system. The basic philosophy in organizing the ESCB/eurosystem is to have all decisions taken centrally by the ECB Governing Council and the implementation of these decisions, i.e. operations, which account in practice for most of an NCB's work, is effected by the NCBs on a decentralized basis, coordinated by the ECB Executive Board. Preparatory work by the EMI has shown that decentralization of a very

¹⁷ The General Council can be regarded as a transitional decision-making body. It performs those duties which were originally assigned to the EMI and which the ECB must carry on due to the fact that not all Member States have adopted the euro. The General Council meets four times per year. For more information, see Scheller, 2004, pp. 61–62.

¹⁸ This divergence in numbers arises from the fact that the OeNB does not participate in several subordinate groups due to the topics covered, while in some cases two representatives are nominated for certain committees and subordinate groups.

large portion of the central banks' operative activities is both "possible" and "appropriate" (Liebscher, 1998). The decentralized approach has permitted the use of the NCBs' infrastructure and longstanding experience, which was of benefit for the entire eurosystem.

Decentralized implementation means that the OeNB now acts and continues to act in the following business areas within the ESCB/eurosystem, some of which have been subject to progressing harmonization since the start of the ESCB/eurosystem: Preparation of monetary policy information for the governor, implementation of monetary policy decisions, management of reserve assets, public relations, cooperation in the supervision of domestic credit institutions as well as payment systems oversight in order to ensure the stability of the financial markets, provision of analyses and statistics, cooperation in international financial institutions, domestic cash supply and payment processing.

Participating in the monetary union also required the OeNB to intensify its economic analysis activities, which serve as the basis for the positions taken by the OeNB governor in the Governing Council and General Council of the ECB. In the implementation of monetary policy, a number of changes were made in the policy instruments deployed as well as the responsibilities of the OeNB in this area. In the eurosystem's open market operations, the OeNB's main duties are to collect tender offers and forward them to the ECB, to inform credit institutions of the allotment results and to settle the transactions. The OeNB also acts as the credit institutions' counterparty for the standing facilities (OeNB, 1999, pp. 42–43). As regards the management of reserve assets, the bulk of Austria's reserves has remained in the hands of the OeNB but is managed according to rules defined by the ECB's Governing Council. In order to ensure a comparable information basis within the eurosystem, statistical requirements also increased with regard to accuracy, level of detail and timeliness. In addition, efforts to harmonize statistical data at the international level were also enhanced. Supplying banknotes and coins has remained one of the OeNB's main duties. As of January 1, 1999, the Austrian RTGS payment system ARTIS was integrated into the TARGET network interlinking national payment systems (OeNB, 1999, p. 43). In its public relations work for the eurosystem, the OeNB plays a special role as an "ambassador" for European monetary policy in Austria and thus makes a valuable contribution to the eurosystem's communication policy (Hochreiter, 2000, p. 307).

The precise distribution of tasks in the eurosystem is subject to ongoing adaptation and discussion. While the debate about the centralized or decentralized orientation of the system has not subsided since its inception, the eurosystem is still clearly decentralized with regard to the execution of tasks. Activities have only been centralized in the area of payment systems among several NCBs and in representation by the ECB in several EU bodies. For example, since Austria's EU accession the OeNB has been represented in the EFC, but the OeNB's – and other NCBs' – level of participation was reduced in the course of EU enlargement.

However, the OeNB is still represented in the EU bodies responsible in the fields of banking supervision, international cooperation (IMF) and technical preparation for the euro introduction in additional Member States.

Furthermore, decisions of the ECB Governing Council and the resulting legal acts sometimes allow – but do not require – all national central banks to take part in a given task and its implementation. For this reason, it appeared especially sensible for the OeNB (as a relatively small NCB) to establish itself as a universal central bank with selected areas of specialization within the eurosystem. For example, the focus of economic research and analysis at the OeNB¹⁹ has shifted due to monetary policy integration, and the following three specialist areas have emerged: 1) economic analysis of the euro area as a whole, 2) analysis of the Austrian economy and 3) specialization in the analysis of Central, Eastern and Southeastern European countries as well as the economic analysis of the transition process. Through a number of targeted measures which were already initiated in the early 1990s, the OeNB succeeded in developing its focus on Central and Eastern Europe into a special area of economic analysis and research within the eurosystem and in building up an outstanding network of working contacts.²⁰ In response to the enlargement of the EU in 2004, the OeNB has redefined its research priorities over the last year and will sharpen its focus on the countries of Southeastern Europe, which constitute the future generation of EU candidate and accession countries. Consequently, the OeNB has also started to intensify its bilateral contacts with the central banks in these countries.

3.3 The Euro Cash Changeover Poses a Challenge to Communication Policy and Logistics

In parallel to the activities mentioned above, the OeNB also had to deal with very important agendas on the domestic front, especially communicating, preparing and implementing the changeover to euro banknotes and coins. In terms of logistics and communication, this transition was one of the greatest challenges the OeNB has ever faced. Given the scale of the project, planning began at a very early stage. The new currency was given the name “euro” in 1995, and the decision to use the banknote designs submitted by the OeNB (Robert Kalina) was taken in 1996.

In the context of its euro change over master plan the OeNB had set up a special cash change over project, that involved not only the OeNB, but also the print works, the mint – both of them being 100% subsidiaries of the OeNB – and a

¹⁹ In addition, the OeNB has been supporting Austrian research with considerable funds for almost 40 years now.

²⁰ For an overview of the OeNB's concrete activities in connection with its focus on Central and Eastern Europe, see OeNB, 2003, pp. 55–57.

specifically created cash logistics company²¹. The project was headed by a Board Member of the OeNB. Information was fed regularly into the EMU task force also in order to coordinate ongoing communication activities with the “Euro-Initiative” of the federal government. OeNB experts took part in the ESCB cash changeover committee (CASHCO) to monitor the preparations for the introduction of the euro at the NCBs and to enhance coordination among the ECB and the NCBs.

Significant activities in the run-up to the euro cash changeover included the production of the banknotes and coins themselves, massive frontloading of cash to banks and certain companies as well as to the public in the form of coin “starter-kits”, insuring security and increased storage capacities, training of cash experts (up to 120.000 in Austria) and last, but not least supplying the citizens with euro cash and withdrawing the former national currencies. It can be regarded as a particular success on the OeNB's part that the euro banknotes and coins enjoyed swift acceptance among the vast majority of Austrians from the very beginning. Just two weeks after the introduction of the new currency, some 90% of all cash transactions were settled in euro, although the dual circulation period officially lasted for two months. Taking the Austrian schilling out of circulation imposed very different logistical demands, especially because the decision as to when, how much and which denominations of the old currency to turn in was left to the discretion of the people. For this reason, numerous activities were carried out in order to remove the schilling from circulation (OeNB, 2002, pp. 21–23).

As to communication policies, already by mid 1997 the Federal Government had set up a “Euro-Initiative” for communication relating to the euro change over, with which the OeNB coordinated its own euro public relations efforts very closely. While the decision, which countries would participate as a first wave in the 3rd stage of Monetary Union was taken and the euro area was created on January 1, 1999, the euro cash change over only followed in 2002. This led to a prolonged non euro cash transition period of three years. With hindsight, this prolonged transition period led to higher transition costs for all sectors involved and to a more complex communication with the general public. Communication by the “Euro-Initiative” and the OeNB concentrated in a first stage before January 1999 on creating a favourable climate for the Euro, i.e. it being as stable a currency as the Schilling, because the population regarded the Schilling as a guarantor of economic success. In a second stage between 1999 and 2002 the focus of communications shifted to the when and the how of the euro cash introduction. In early 2001, the OeNB launched a campaign which aimed to create a positive attitude toward the euro among the population and preceded the main campaign “Mit der Nationalbank

²¹ The GELDSERVICE AUSTRIA Logistik für Wertgestionierung und Transportkoordination G.m.b.H. (GSA), which was put in charge of developing efficient cash logistics in Austria (OeNB, 2002, pp. 17–20 for a detailed description of all measures taken in this context).

zum Euro” (The OeNB – Making the Euro Yours) in the fall of 2001 (OeNB, 2002, pp. 23–26).

It is difficult to quantify the impact the euro cash change over had on inflation and whether price hikes were change-over related or not, as price developments were affected by a number of factors at the time of the cash change over (Gruber et al., 2005, p. 71). Nevertheless, even after a smooth transition to euro banknotes and coins, continued efforts have to be made at communication and at trust-building measures. Such measures have included assisting the population in getting a feel for the value of the new currency and combating the problem of (subjectively) “perceived inflation” in the Austrian population (OeNB, 2003, pp. 19–20).

4. Concluding Remarks

In conclusion, it can be stated that as an institution the OeNB was (and is) heavily influenced by Austria’s accession to the EU. This can mainly be attributed to the fact that the intensity of European integration has increased markedly in the last ten years, especially in the area of monetary policy.

From the very outset, the OeNB clearly demonstrated its commitment to the objective of ensuring that Austria would take part in the monetary union as early as possible. The transition to a single European currency in early 1999 as well as the euro cash changeover in 2002 were among the greatest challenges the OeNB has had to face in its entire 190-year history.

The integration of the OeNB into European decision-making bodies and fora has changed the bank’s working methods at all hierarchical levels and in all fields. In particular, the OeNB’s cooperation with the ECB and other NCBs in the ESCB/eurosystem has also brought about significant pressure in terms of quality and competition as a result of ongoing changes and adaptation requirements.

However, the OeNB has succeeded in maintaining its role as a think tank and decision-making body for economic policy in Austria, and in making a contribution to stability and peace in the enlarged EU within the framework of European institutions and the eurosystem.

References

- Bartik, S., S. Konrad-El Ghazi and H. Nekvasil. 2004.** Zentralisierung-Dezentralisierung-Spezialisierung im Eurosystem. OeNB. November (unpublished).
- Dirschmid, W., M. Fluch and E. Gnan. 2001.** Economic Aspects of the Euro Cash Changeover in Austria. OeNB. Focus on Austria. 2nd Quarter. 194–216.
- Dvorsky, S. and I. Lindner. 2003.** Anpassung der Stimmrechtsmodalitäten im EZB-Rat. In: Berichte und Studien 2. 144–153.

- Dvorsky, S. and I. Lindner. 2005.** 10 Years of EU Membership: The OeNB in a Changing Environment. OeNB. Monetary Policy & the Economy Q2. 42–52.
- ECB. 1999.** The Institutional Framework of the European System of Central Banks. In: ECB Monthly Bulletin. July. 55–63.
- EMI. 1996.** Progress towards Convergence. November.
- EMI. 1997.** The European Monetary Institute. September.
- EMI. 1998.** Convergence Report 1998.
- European Commission. 1998.** Commission's Recommendation Concerning the Third Stage of Economic and Monetary Union. Convergence Report 1998.
- European Commission. 2005.** Towards EMU, a Chronology of Major Decisions, Recommendations or Declarations in this Field. In: European Economy, DG ECFIN, Occasional Papers. February.
- Gruber, T. and D. Ritzberger-Grünwald. 2005.** The Euro Changeover in the New Member States – A Preview. OeNB, Focus on European Integration Q1. 52–75.
- Hochreiter, E. 2000.** The Role of National Central Banks (NCBs) in the Eurosystem: Current State of Play. In: Atlantic Economic Journal. Vol. 28, 3. 300–308. September.
- IFES. 2005.** OeNB-Barometer, 2. Quartalsbericht, Bevölkerungsbefragung. Vienna, June.
- Liebscher, K. 1998.** The Role of a National Central Bank within the ESCB as Illustrated by the OeNB. Economics Conference of the OeNB. May 7.
- Mooslechner, P. 2005.** 10 Years of Austrian EU Membership: Elements of an Overall Economic Assessment. OeNB. Monetary Policy and the Economy Q2. 28–41.
- OeNB. 1995.** Annual Report 1994.
- OeNB. 1996.** Annual Report 1995.
- OeNB. 1997.** Annual Report 1996.
- OeNB. 1998a.** Annual Report 1997.
- OeNB. 1998b.** Zusammenfassung OeNB-Masterplan-Projekte 1996–2002. July.
- OeNB. 1999.** Annual Report 1998.
- OeNB. 2000a.** Annual Report 1999.
- OeNB. 2000b.** Die Oesterreichische Nationalbank als moderne Zentralbank. June.
- OeNB. 2001.** Annual Report 2000.
- OeNB. 2002.** Annual Report 2001.
- OeNB. 2003.** Annual Report 2002.
- OeNB. 2004a.** Annual Report 2003.
- OeNB. 2004b. Intellectual Capital Report 2003. Knowledge for Stability.**
- OeNB. 2005.** Federal Act on the Oesterreichische Nationalbank (Nationalbankgesetz 1984 – NBG). BGBl. (Federal Law Gazette) No. 50/1984. As Amended by BGBl. No. 161/2004.

Protocol (No. 18) on the Statute of the European System of Central Banks and of the European Central Bank. 1992. Protocol to the Treaty Establishing the European Community.

Scheller, H. P. 2004. The European Central Bank. History, Role and Functions. ECB.

Taborsky, M. and F. Rumler. 2003. Highlights of the Euro Changeover. Presentation Joint Vienna Institute. February 14.

Tumpel-Gugerell, G. 2002. Die OeNB auf dem Wege zu einem modernen Dienstleistungsunternehmen. In: Liebscher (ed.). Vom Schilling zum Euro – Beiträge zur Zeitgeschichte der österreichischen Wirtschaftspolitik und der Oesterreichischen Nationalbank. Festschrift zum 65. Geburtstag von Präsident Adolf Wala. Vienna.

Treaty on European Union. 1992. February 7.

Comparing Central Bank Legislation in Southeastern Europe: Selected Cases

*Sandra Dvorsky*¹

Oesterreichische Nationalbank

1. Introduction

In the past decades, the degree of central bank independence (CBI) has increased worldwide. This tendency was even more prevalent in transition economies, where ambitious central bank reforms were enacted, endowing the central banks with a high degree of legal independence.

This overall tendency towards more CBI was mainly motivated by two reasons: First, the mainstream of academic literature agrees that a relatively high degree of CBI is generally desirable. Empirical studies, such as calculations by Cukierman (1992), suggest that at least for industrial countries, there is a negative correlation between CBI and inflation performance. A brief literature survey on the economic rationale for CBI can be found, for instance, in Maliszewski (2000). Second, the main driving force for increasing the degree of CBI in Europe was the creation of Economic and Monetary Union (EMU). The preparation of Stage Three of EMU entailed numerous and far-reaching adjustments of central bank legislation for the incumbent EU Member States, as national central bank (NCB) statutes had to be adapted to the requirements set out in the Treaty² and the Statute³. The European Monetary Institute (EMI), the predecessor of the European Central Bank (ECB), identified a number of provisions in the NCB statutes that were not in line with Treaty requirements and in its first Convergence Report (EMI, 1996) called for adaptations prior to the beginning of Stage Three of EMU. With the completion of

¹ The author gratefully acknowledges comments by Paul Schmidt, European Affairs and International Financial Organizations Division, and Thomas Wagner, Legal Division (both Oesterreichische Nationalbank).

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

³ Protocol on the Statute of the European System of Central Banks and of the European Central Bank (1992), referred to as “the Statute” hereinafter.

this process and the beginning of Stage Three, the main elements of CBI have become part of the *acquis communautaire* (referred to as “*aquis*” in the following).

This paper draws heavily on an article published in late 2004, which compares central bank legislation in seven Southeastern European (SEE) countries.⁴ For the purpose of this Workshop, the analysis will be confined to the three SEE countries represented on the panel, i.e. Bulgaria, Macedonia⁵ and Turkey, and a comparative overview on current central bank legislation in these three countries will be presented. For the sake of comparison, reference will be made to other SEE countries for some selected issues. All the countries under consideration have declared their objective of joining the European Union and are on their way towards accession, with Bulgaria being very close to the “finishing line” and with a longer way to go for Macedonia and Turkey. Bulgaria signed the Accession Treaty with the EU on April 25, 2005, with the objective to join in January 2007.⁶ Macedonia submitted a formal application for EU membership in March 2004, the European Commission’s Opinion (“*avis*”) on this application was published in November 2005 (European Commission 2005b and 2005c) and Macedonia was formally granted candidate country status by the EU in December 2005 (European Council, 2005, Article 24). Furthermore, a Stabilisation and Association Agreement (SAA)⁷ between Macedonia and the EU entered into force on April 1, 2004. Turkey, which had submitted its application for membership as early as in 1987, was officially recognized as a candidate country at the Helsinki European Council of December 1999 (European Council, 1999, Article 12). The actual start of the accession negotiations took place on October 3, 2005.

Like most transition countries, the three countries analyzed have implemented comprehensive reforms of their central bank legislation in the past years: Bulgaria amended its central bank law in April 2005 in order to implement the required adaptations in time before joining the EU. The Macedonian central bank law was adopted in 2002 and amended several times subsequently. Currently, preparations for a new Macedonian central bank⁸ law are underway and the new law is expected to be passed by the parliament in 2006 (for the main features of the new law,

⁴ See Dvorsky (2004). This article did not yet deal with the recent amendment of the Bulgarian central bank legislation, nor did it cover Turkey. Also see section 2 of this paper.

⁵ The country was recognized by the EU under the name of Former Yugoslav Republic of Macedonia (FYROM), and will be referred to as “Macedonia” in the following.

⁶ However, the Accession Treaty includes the possibility of postponing Bulgaria’s accession by one year, if “there is a serious risk of (Bulgaria) being manifestly unprepared to meet the requirements of membership by the date of accession of 1 January 2007 in a number of important areas” (Protocol 2005, Article 39).

⁷ This was the first Stabilisation and Association Agreement to enter into force in the Western Balkans.

⁸ The central banks are referred to by their English designation hereinafter.

(Stojanovski, in this volume). The Turkish law underwent a fundamental reform in 2001.

When it comes to the accession of these countries to the European Union, their legal status will be comparable to that of the so-called “new” EU Member States, i.e. those 10 countries which joined the EU on May 1, 2004. This means that they will participate in EMU from the date of their accession as “Member States with a derogation.” Therefore, as Treaty requirements in the area of CBI constitute part of the *acquis communautaire*, they will have to bring in line their central bank legislation with Treaty requirements prior to or upon accession. The purpose of this paper is to provide a qualitative overview on central bank legislation in the three countries and to assess the degree of CBI already achieved, using the Treaty requirements as a yardstick.

The paper is organized as follows: Section 2 provides a brief literature overview on CBI in transition countries, with a particular focus on the coverage of Bulgaria, Macedonia and Turkey. Section 3 compares current central bank legislation in the three SEE countries. Section 4 concludes.

2. Brief Literature Overview

While only selected aspects of CBI in transition countries had been analyzed for a limited number of countries until 1997, an increasing number of authors published both theoretical and empirical work in the years to follow. A survey of early CBI literature on transition countries can be found in Radzyner and Riesinger (1997)⁹. More recent literature, published between 1997 and 2000, is surveyed in Dvorsky (2000).

Recent literature on CBI in transition economies seems to have focused largely on measurement issues. Based on Cukierman’s pioneering work (1992), Cukierman et al. (2000) presented extensive new data, measuring the degree of legal CBI in 26 transition countries. For the sake of comparability, the authors use the index of legal CBI developed earlier and find that central bank reforms implemented by the transition countries in the 1990s were very ambitious, with levels of legal CBI even higher than those of developed economies during the 1980s. While Bulgaria and Macedonia are included in the country sample analyzed by Cukierman et al. (2000), none of the central bank laws currently in force was examined. In a similar vein, Maliszewski (2000) presents data on 20 Central and Eastern European transition countries. The author introduces two indices of legal CBI, which cover political and economic aspects, drawing heavily on the methodology developed earlier by Grilli et al. (1992). Maliszewski examines the relationship between inflation and CBI and concludes that changes in central bank

⁹ The author published this earlier study jointly with Olga Radzyner under her family name Riesinger in 1997.

laws are highly significant in explaining inflation rates. Maliszewski's paper covers two of the three countries selected for this article, namely Bulgaria and Macedonia, but measurement is applied to legislation not in force anymore. The issue of CBI in Turkey is neither covered by Cukierman's nor by Maliszewski's work. Dvorsky (2000) measures the degree of legal and actual CBI in five Central and Eastern European transition economies, namely the Czech Republic, Hungary, Poland, Slovenia and Slovakia (CEEC-5), by applying the two most widely used indices, namely the Cukierman and the Grilli-Masciandaro-Tabellini (GMT) index. The paper compares own findings with those of other authors and earlier calculations and critically reviews the indices on legal and actual CBI themselves, in particular against the background of the Treaty requirements. Ilieva et al. (2001) take an interesting approach and construct a new CBI index, which takes into account legislative and behavioral aspects of CBI. Results from surveys of central bank officials are compared to those of independent academic institutions. Not surprisingly, the results show that CBI is higher in transition economies planning early EU accession than in others. The country sample chosen by Ilieva et al. includes Bulgaria and Macedonia. Freytag (2003) analyzes the state of legal CBI in selected transition countries by developing an index of "monetary commitment" and comparing results to earlier measurement by Cukierman et al. (2000), Maliszewski (2000) and Dvorsky (2000). The author concludes that the degree of CBI in the countries examined is quite high. Gros (2004) examines possible financial aspects of CBI and discusses the case of Turkey, measuring effects of price stability on seignorage. Dvorsky (2004) provides a qualitative overview on central bank legislation in SEE, namely Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania and Serbia, and assesses the degree of CBI already achieved.

3. Comparing Central Bank Legislation

Apart from empirical literature on CBI issues, central bank legislation in the SEE countries is and will be subject to an "institutionalized assessment" to be carried out regularly by the European Commission and, at a later stage, also by the ECB. For Macedonia, the Annual Report on the Stabilisation and Association process for Southeastern Europe by the European Commission provided the first "institutionalized" assessment. This report examined the countries' readiness to move closer to the EU in a very general manner and did not touch separately upon the issue of CBI (European Commission, 2004a). The next step was the European Commission's Opinion ("avis") on Macedonia's application to join the EU. Such an "avis" typically deals with the most important aspects of CBI in the chapter on "Economic and Monetary Union" and examines the country's ability to fulfil the

requirements of the *acquis* in the field of EMU in the medium term.¹⁰ For countries that have gained official candidate status, the European Commission publishes so-called “Progress Reports”¹¹ every year. These reports, which were first published in 1998 on the 10 candidate countries at that time, provide an annual update of the Commission’s assessment on the candidate countries’ preparedness to fulfil the Copenhagen criteria, thus following up on the first-time judgment presented in the respective Opinion. Consequently, the structure of the Progress Reports is very similar to that of the Opinion on each country, dealing with the issue of legal CBI in the chapter on “Economic and Monetary Union”.¹² In 2004 and 2005, the countries covered by the Commission’s Progress Reports comprised the “accessing countries” Bulgaria and Romania as well as the “candidate countries” Croatia and Turkey. As of 2006, the European Commission will also produce a Progress Report on Macedonia every year. After EU accession, NCB statutes will be examined at least every second year in the ECB’s and the European Commission’s Convergence Reports¹³, an important part of which analyzes in detail the current state of NCB legislation in Member States with a derogation (e.g. ECB, 2004 and European Commission 2004d and 2004e).

According to Article 109 of the Treaty, “each Member State shall ensure, at the latest at the date of the establishment of the ESCB, that its national legislation including the statutes of its national central bank is compatible with this Treaty and the Statute of the ESCB”. For countries that joined or will join the EU after the establishment of the ESCB in June 1998, this implies that they had or will have to adjust their national legislation in the area of CBI by the date of EU accession (ECB 2004, p. 24 and European Commission 2004e, p. 9). Inter alia, Article 109 relates to the following two areas of legislation: first, the definition of the national central bank’s objectives (Article 105 (1) of the Treaty), second, the independence of the NCB, comprising the freedom from instructions (Article 108 of the Treaty), provisions protecting the legal status of the central bank’s top officials (Article 14 (2) of the Statute) and the financial independence of the central bank (EMI, 1996, p. 102–103). A third area of legislation, namely the prohibition of monetary financing and of privileged access to financial institutions (Articles 101 and 102 of the Treaty, respectively; European Commission 2004e, p. 9–12) had to be implemented by the Member States even earlier, namely at the beginning of Stage

¹⁰ A detailed analysis of the first Progress Reports with respect to central banking issues can be found in Dvorsky et al. (1998).

¹¹ Regular Reports on a country’s progress towards accession, also referred to as the “Progress Reports”.

¹² While for previous accession countries, the issues of “economic and monetary union” were dealt with in chapter 11 of the respective “avis” and subsequent progress reports, this has moved to chapter 17 for Turkey and Macedonia.

¹³ According to Article 122(2) of the Treaty, such Convergence Reports must be prepared at least once every two years, or at the request of a Member State with a derogation.

Two of EMU in January 1994 (Article 116 of the Treaty). These three areas of legislation are clearly defined as *acquis* and consequently have to be *enacted and to become effective* at the latest upon EU accession (“pre-accession requirements”). Therefore, this paper will examine the state of compliance of Bulgarian, Macedonian and Turkish legislation with these three areas of the Treaty.

In addition, Article 109 requires further adaptations, which relate to the full legal integration of an NCB into the Eurosystem, regulating for instance the adjustment of monetary policy instruments.¹⁴ These adaptations, which will be referred to as „integration requirements“ in the following, need only *enter into force* at the date on which the Member State adopts the single currency (European Commission 2004e, p. 14 and ECB, 2004, p. 30, respectively).¹⁵ On the required timing of *enactment* of the integration requirements, the Treaty is not unambiguously clear: The European Commission takes the view that “new Member states are expected to adjust their national legislation as soon as possible after their accession to the EU” and “...to ensure compliance in time for the next Convergence Report” (European Commission 2004e, p. 14). The ECB uses a slightly different wording and argues that the integration requirements have to be enacted by... the date of accession as regards the NCBs of the new Member States (ECB 2004, 30). However, these two slightly diverging interpretations of the Treaty will be of marginal relevance for those countries, which adopt the euro as fast as possible after their respective EU accession.

For comparing and analyzing current central bank legislation in the three countries, the four-tier classification introduced by the EMI will be applied. In its first Convergence Report, the EMI established a list of features of CBI (EMI, 1996, pp. 100–103), which was elaborated further by the ECB¹⁶ in the subsequent years and which still provides the analytical framework for examination of CBI in the

¹⁴ Article 43.1 of the Statute – in analogy to Article 122 (3) of the Treaty – lists Articles which do not apply to Member States with a derogation. These Articles comprise the adjustment of monetary policy instruments, the mandatory transfer of foreign reserve assets to the ECB, the ECB’s exclusive right to issue banknotes etc. (European Commission, 2004e, pp. 12–13)

¹⁵ It is interesting to note that the Convergence Reports of the European Commission and the ECB not only review the integration requirements, but also the pre-accession requirements. The European Commission argues that the convergence assessment covers these areas of legislation, because national legislation could have been amended in the meantime (European Commission 2004e, p. 9).

¹⁶ In particular, the ECB has the right to deliver Opinions on draft laws, based on Article 105(4) of the Treaty, the first indent of Article 4(a) of the Statute and the third indent of Article 2(1) of Council Decision 415/98/EC of 29 June 1998 on the consultation of the European Central Bank by national authorities regarding draft legislative provisions. In the field of CBI, the ECB has made use of this possibility on numerous occasions. See: <http://www.ecb.int/ecb/legal/1341/1345/html/index.en.html>, retrieved on October 14, 2004.

current Convergence Reports. Therefore, the structure of this paper will be broadly based on the EMI's classification and incorporate some considerations from an earlier article (Radzyner and Riesinger, 1997). Thus, the following four aspects of CBI are discerned: First, the definition of statutory objectives in central bank laws will be examined, which largely corresponds to the concept of functional independence according to the EMI methodology. Second, the paper deals with institutional independence in a very broad sense, covering inter alia the central banks' independence in the formulation and implementation of monetary policy. Third, the issue of personal independence will be analyzed. This aspect relates to the legal status of the central bank governor and other members of the highest decision-making body and corresponds to the EMI definition. Fourth, financial independence will be examined, comprising two aspects, namely the budgetary independence of the central bank itself and, going beyond the definition of financial independence used by the EMI, the prohibition of monetary financing. Given the importance of this issue for CBI, it will be included in the definition of financial independence in this paper.¹⁷

3.1 Statutory Objectives – Functional Independence

There is agreement that independent central banks must have a single, rather narrowly defined policy objective which focuses on the stability of the domestic currency. This postulate is related to the need for transparency and credibility of monetary policy.¹⁸ However, having a single policy goal does not mean that the central bank can ignore other macroeconomic goals. Therefore, the Statute as well as numerous central bank laws contain a secondary objective, namely the support of general economic policies, provided that it does not jeopardize the achievement of the primary objective.

The EMI's concept of functional independence is based on Article 105 (1) of the Treaty and Article 2 of the Statute, according to which the "primary objective of the ESCB shall be to maintain price stability." And, further, on the secondary objective: "Without prejudice to the objective of price stability, it shall support the general economic policies in the Community."

¹⁷ Neither the EMI nor its successor, the ECB, have analyzed the prohibition of monetary financing in their past Convergence Reports, although taking fully into account of this Treaty requirement in their monitoring function (according to Article 180d of the Treaty). The European Commission touched upon the issue several times (e.g. European Commission 2004e, p. 13). In a similar vein, the European Commission's Opinions and Regular Reports on candidate countries deal with this issue when analyzing their ability to join the EMU.

¹⁸ On the rationale of the formulation of central bank policy objectives, see Radzyner and Riesinger (1997, p. 61).

All three central bank laws analyzed contain a clearly defined policy objective for the central bank and do explicitly refer to “price stability” as the primary objective (annex, table 1). The wording of Bulgaria’s central bank law on the primary objective was amended a few months ago and now fully complies with the Maastricht requirements. Before the amendment, the law had made reference to “stability of the national currency”, a wording, which did not unambiguously reflect the primacy of price stability (Dvorsky, 2004, p. 55). All three central bank laws under consideration also provide for a secondary policy objective and contain a stipulation on the support of general economic policy of the government, without prejudice to the primacy of price stability. While the wording in the Bulgarian legislation is perfectly in line with Treaty requirements in this area, the Macedonian central bank law stipulates that the central bank shall also strive for supporting economic policy and maintaining financial stability. The Turkish central bank law even provides for the central bank supporting growth and employment policies, a formulation which may carry a potential of conflicting goals for monetary policy. To sum up, the primary statutory objectives are fully in line with the Treaty, whereas some adaptations will be needed as regards the area of secondary objectives.

3.2 Formulation and Implementation of Monetary Policy – Institutional Independence

The concept of institutional independence is used differently in the literature: The EMI applied a very narrow definition of institutional independence, based on Article 108 of the Treaty and Article 7 of the Statute (EMI, 1996, p. 100). These provisions prohibit the ECB, the NCBs and the members of their decision-making bodies to take or seek instructions from Community institutions or bodies, from any government of a Member State or from any other body. Smits (1997, p. 155) presents a somewhat broader concept, which comprises freedom from instructions and the legal personality of the central bank, which must be an institution separate from other government bodies. This section will compare provisions governing the relationship between the central banks and their respective governments, thus covering inter alia institutional independence according to the EMI’s narrow and Smits’ somewhat broader definition. Furthermore, this paper takes an even broader approach and examines whether the central bank laws under consideration endow their central banks with the necessary competences to formulate and implement monetary policy in order to achieve the primary objective independently.

As to institutional independence as defined by the EMI, the freedom from instructions for the central bank is explicitly stipulated in the Bulgarian and Macedonian central bank laws (see annex, table 1). The Turkish legislation, on the contrary, does not only lack a legislated freedom from instructions, but also obliges the central bank to perform one of its key strategic tasks, namely the determination

of the inflation target¹⁹, jointly with the government (see annex, table 1). This provision is an equivalent of an obligation to consult ex ante a third party endowing the latter with a formal mechanism to influence the final decision and can therefore be regarded as incompatible with the Treaty and the Statute. The provision was criticized by the Progress Report (European Commission, 2005d, p. 91). Furthermore, Article 42 of the Turkish central bank law allows the prime minister to have the operations and accounts of the central bank audited. This provision carries the potential of exerting political pressure on the central bank (Yesiladali, in this volume). Another interesting area of legislation potentially jeopardizing institutional independence is the possibility of a disagreement within the central bank's highest decision-making body: The most common approach to deal with such situations, which is also found in a number of SEE central bank laws (Dvorsky, 2004, p. 66), is to assign a casting vote to the governor. However, Article 26.2 of the Turkish central bank law empowers the prime minister to act as an arbitrator in case of disagreement between the Board and the Governor. In a similar vein, Article 67 of the Macedonian central bank law deserves a comment: While the competence for establishing and implementing monetary policy lies in principle with the central bank's highest decision-making body, i.e. the National Bank Council, the parliament has a final say if the National Bank Council cannot achieve the necessary majority for decision-making. Article 67 of the Macedonian central bank law is particularly interesting, because the required majority for the most important decisions, namely those on monetary policy objectives, is set at "more than two-thirds of all members" with an additional presence quorum of six members, including the governor or vice governor. Consequently, it does not seem unlikely that the National Bank Council fails to reach agreement, so that in practice parliament may get the final say, thus de facto curbing CBI. To sum up, the Turkish and the Macedonian legislation require a number of substantial adjustments in the area of institutional independence, while Bulgaria's central bank law is largely in line with the Treaty. However, the prohibition of external influence on the central bank as understood by the EMI covers all possible sources of influence, both at the national level (governments, parliament) and at the EU level (Community institutions or bodies) and different forms of influence (the right to give instructions, the right to approve, suspend, annul, defer or censor decisions). Therefore, even the wording of the Bulgarian central bank law will have to be further adapted in order to fully comply with the Maastricht criteria in this area.²⁰

¹⁹ The Turkish central bank will begin to practice the regime of inflation targeting in 2006 (Central Bank of the Republic of Turkey, 2005, p. 3).

²⁰ As a case in point, the Commission's Convergence Report 2004 identifies a number of weaknesses and imperfections in the respective section on institutional independence for some of the new Member States (European Commission 2004e, p. 10). In a similar vein,

The postulate to provide the central bank with legal personality relates to the fact that the monetary authority is a separate body and not part and parcel of the government administration (Smits, 1997, p. 162). For the ECB, this element of institutional independence is laid down in Article 107 (2) of the Treaty. It is worth noting that the central banks of Bulgaria and Macedonia are defined as legal entities according to the respective central bank laws.²¹ In this context, the issue of “statutory independence”, i.e. an explicit reference to the “independent” status of the central bank in the wording of the central bank law, deserves a closer look. Although “statutory independence” is generally not seen as a necessary precondition to achieving a high degree of legal CBI, it is interesting that all central bank laws under consideration do contain such a stipulation.²²

According to Article 105 (2) of the Treaty and Article 3.1 of the Statute, one of the basic tasks of the ESCB is the definition and implementation of the monetary policy of the Community. The Macedonian and the Turkish central bank are provided with the formal responsibility to design and implement monetary policy in their countries (see annex, table 1). The Turkish central bank, however, has to determine the inflation target in cooperation with the government (see above). In Bulgaria, the design of monetary policy is determined by the currency board arrangement, which naturally leaves no room for the central bank to independently design the monetary policy regime.

Whether the choice of the exchange rate regime should be the sole competence of the central bank or is to be jointly decided by the central bank and the government is not answered unambiguously by the literature. As a minimum requirement for effective CBI, a close involvement of the central bank in decisions on the choice of the exchange rate regime is generally seen as desirable (e.g., Swinburne and Castello-Branco, 1991, p. 40). While the central bank of Macedonia has the sole competence for determining the exchange rate regime, the Turkish central bank has to take these decisions jointly with the government. For Bulgaria, this choice is determined by the currency board arrangement (see annex, table 1).

3.3 Personal Independence

The definition of personal independence is largely undisputed and relates to arrangements on the role, status and composition of the central banks’ highest decision-making bodies. This includes appointment procedures, the length of the

the ECB’s Convergence Report 2004 examines institutional independence in a rather strict sense (ECB, 2004, p. 227 or 232).

²¹ See Article 1.1 of the Law on the Bulgarian National Bank (1997) and Article 5 of the Law on the National Bank of the Republic of Macedonia (2002).

²² See Article 44 of the Law on the Bulgarian National Bank (1997), Article 4 of the Law on the National Bank of the Republic of Macedonia (2002) and Article 4 III c of the Law on the Central Bank of the Republic of Turkey (1970).

term of office and the possibility of a renewal of mandate, rules for dismissal, requirements for professional competence and incompatibility clauses.

While the governments typically have a primary role in the appointment of the members of the central banks' highest decision-making bodies, it is widely agreed that certain limitations on the governments' appointment powers increase the degree of CBI. Such limitations may include, for example, a proportion of nongovernment appointments or the right to nominate candidates, e.g. by the state president or by the parliament (Swinburne et al., 1991, p. 31). These requirements are, *inter alia*, reflected in the construction of different models to measure CBI (Cukierman, 1992; Grilli et al., 1991). While the Treaty and the Statute contain appointment procedures for the members of the ECB executive board, these provisions are not comparable to the appointment of NCB officials and therefore, the Progress Reports and the Convergence Reports remain silent on national appointment procedures. In Bulgaria and Macedonia the central bank governor is elected by the parliament – a procedure which is very common also in other SEE countries (Dvorsky 2004, p. 58) – with the Macedonian governor being proposed by the state president (see annex, table 2). The Turkish central bank governor is appointed directly by the government. As to the appointment procedures for the other members of the highest decision-making bodies, the picture in the three countries analyzed is more diverse: while in all three countries the governor has the right to propose vice (or deputy) governors, legislated appointment procedures differ considerably (see annex, table 2). In this context it is worth noting that the Turkish central bank – unlike the other two central banks analyzed – has a three-tier structure of decision-making bodies: The highest decision-making body in the area of monetary policy is the Monetary Policy Committee, which is endowed with the task of setting the principles and the strategy of monetary policy. Moreover, the Monetary Policy Committee is in charge of determining the inflation target together with the government. The second decision-making body of the Turkish central bank is the Board, which basically is responsible for implementing the monetary policy, as well as for other areas of central banking and for the central bank's annual budget. The third body is the Executive Committee, which is not involved in monetary policy decisions, but is in charge of the internal management of the central bank.²³

It is generally agreed that the legislated term of office of top central bank officials has to be clearly longer than the electoral cycle in order to limit political influence. This requirement is taken into account in Article 11.2 of the Statute, which sets the term of office for the members of the ECB Executive Board at eight years, which is definitely longer than any electoral cycle in Europe. Furthermore,

²³ The duties of the Monetary Policy Committee are stipulated in Article 22A of the Turkish central bank law, those of the Board in Article 22 and those of the Executive Committee in Article 30.

the minimum term of office required for governors of NCBs is established as five years (Article 14.2 of the Statute).²⁴ The EMI (1996, p. 102) argues that this minimum term of office also applies to the other members of the highest decision-making body. A related question is the issue of renewal of mandate: The possibility of reappointment of top officials is generally seen as decreasing the level of CBI. According to the Statute, members of the ECB Executive Board may not be reappointed, whereas it does not contain any rule on reappointment for NCB governors. Therefore, it is assumed that the possibility of renewal of mandate is compatible with the Statute (Smits, 1997, p. 165). With regard to the legislated length of tenure, the Bulgarian and Macedonian central bank laws are in line with Treaty requirements (see annex, table 2). As to the Turkish legislation, members of the Board, with the exception of the governor and the vice governor, still have a three-year term. In view of these Board members' responsibilities in the area of monetary policy decisions, their legislated term of office will have to be extended to five years in order to comply with the Treaty. Reappointment of central bank governors and also of other top officials is possible in Macedonia and Turkey, while no explicit reference can be found in the Bulgarian central bank law.

Regarding the rules for removal from office, legislated reasons have to be unrelated to central bank policy and limited to exceptional circumstances clearly defined by law. According to Article 14.2 of the Statute, a NCB governor may only be dismissed for the following reasons: if he no longer fulfills the conditions required for the performance of his duties or if he has been guilty of serious misconduct. The EMI argues that these rules for the security of tenure of office should also apply to the other members of the decision-making bodies of the NCBs (EMI, 1996, p. 102). In the three central bank laws examined, a wide variety of reasons for dismissal can be found (see annex, table 2): apart from the inability to perform functions and serious misconduct, the legislated reasons include criminal acts, false statements, a ban on practicing the profession or incompetence. As the Bulgarian central bank law was amended also in this area, the reasons for dismissal are now limited to the two reasons stipulated by Article 14.2 of the Statute. However, the amended Article 14.1 of the Bulgarian central bank law still makes reference to an incompatibility clause pertaining to membership in the Governing Council and thus indirectly introduces three additional reasons for dismissal of members in the highest decision-making body.²⁵ While this amendment is

²⁴ However, the European Commission's Convergence Report 1998 defines two exceptional cases where the term may be shorter: first, appointment of new members for the remainder of the term of the predecessor and second, a staggered initial appointment (European Commission, 1998, p. 45).

²⁵ Article 14.1 of the Law on the Bulgarian National Bank (1997) stipulates that a member of the Governing Council may be dismissed if "he no longer fulfils the conditions required for the performance of his duties under Article 11.4". Article 11.4 defines persons who may not become members of the Governing Council, namely persons

defended by Grozev as reducing the reasons for dismissal to a maximum extent (Grozev, in this volume), the European Commission gave a critical assessment on this amended provision in its Progress Report (European Commission, 2005a, p. 47). Another requirement, which was identified by the 2004 Progress Report on Bulgaria (European Commission, 2004b, p. 80), has been largely met by the amendment, namely the introduction of provisions for judicial review of dismissal decisions (Article 14.3 of the Law on the Bulgarian National Bank).²⁶ As to Macedonia's and Turkey's legislation on dismissal of central bank top officials, a lot remains to be done in order to comply with the Treaty requirements: First, the number of reasons for dismissal has to be strictly limited in the sense of Article 14.2 of the Statute and second, provisions for judicial review of dismissal decisions are not in place yet. This assessment is also reflected in the European Commission's Progress Report on Turkey (European Commission, 2004c, p. 106, with no progress found in European Commission, 2005d) and in the "avis" on Macedonia (European Commission, 2005b, p. 91).

It is generally acknowledged that requirements concerning the professional qualifications of central bank top officials represent a certain safeguard for CBI, because this rules out persons chosen mainly for political reasons. Article 112 (2) (b) of the Treaty and Article 11.2 of the Statute require as appropriate candidates for membership in the ECB's Executive Board "persons of recognized standing and professional experience in monetary or banking matters." The Treaty and the Statute are silent on requirements for NCB governors. However, all three central bank laws under consideration require personal and professional qualifications for a position in the central bank's highest decision-making body, such as personal integrity, academic degrees, professional experience in monetary and banking matters and experience in public administration.²⁷

Incompatibility clauses for central bank top officials are generally recommended to prevent potential conflicts of interest. While neither the Treaty nor the Statute provide for explicit incompatibility clauses for NCB top officials, Article 11.1 of the Statute contains an exclusivity clause for members of the ECB's Executive Board, according to which the members shall perform their duties on a full-time basis, and "no member shall engage in any occupation, whether gainful or not, unless exemption is exceptionally granted by the Governing Council." The EMI (1996, p. 102) derived the general principle that membership in a decision-making body involved in the performance of ESCB-related tasks is incompatible

"sentenced to imprisonment...", "adjudicated in bankruptcy..." and "previous members of a managing or supervisory body of a company...before its insolvency".

²⁶ However, the Progress Report on Bulgaria 2005 still requires some minor amendments in this area (European Commission, 2005a, p. 47).

²⁷ See Article 11.3 of the Law on the Bulgarian National Bank (1997), Article 58 of the Law on the National Bank of the Republic of Macedonia (2002) and Articles 19, 22A, 25 and 29 of the Law on the Central Bank of the Republic of Turkey (1970).

with the exercise of other functions which might create a conflict of interest. The three SEE central bank laws under consideration contain incompatibility rules, which apply to all members of the highest decision-making body (see annex, table 2). Apart from rather common provisions, such as incompatibility with positions in government, parliament, president of state or positions in commercial banks, the Macedonian central bank law contains a number of stipulations which seem to be in contradiction with the generally shared view that personal integrity is a necessary qualification: According to Article 58 of the Macedonian central bank law, persons convicted of a crime and sentenced to imprisonment may become members of the central bank's highest decision-making body, after a certain waiting time. The length of the waiting time depends on the length of preceding imprisonment.²⁸

3.4 Financial Independence

Financial independence as defined by the EMI refers to the budgetary independence of the central bank itself, i.e. the question whether it has the appropriate means to fulfil its tasks properly. Budgetary independence comprises such issues as rules on the management of the central bank's budget, ownership issues, the allocation of central bank profits and the coverage of potential losses.

As mentioned earlier, this paper uses a broader definition and interprets the term "financial independence" as covering two aspects: first, budgetary independence as described above and, second, the prohibition of monetary financing. As will be shown below, these two aspects of financial independence are closely interrelated.

One of the crucial aspects of budgetary independence is the question whether the central bank is entitled to determine its expenses and revenues autonomously or whether the approval of a government body is needed. It is widely acknowledged that financial dependence of the central bank on government institutions may be detrimental to CBI. While the Treaty and the Statute do not contain explicit provisions on the NCBs' budgetary independence, the EMI (1996, p. 102–103) argues that a fully independent NCB should be able to avail itself autonomously of the appropriate economic means to fulfil its mandate. In particular, *ex ante* influence on an NCB's financial means by external bodies is regarded as jeopardizing the NCB's independence, while *ex post* reviews of an NCB's financial account may be seen as a reflection of accountability (EMI, 1996, p. 105). In the three central bank laws examined, the central bank's budget is managed by the bank's highest decision-making body independently from any government institution (see annex, table 3). In Turkey, however, the prime minister has the right to have the operations of the central bank audited (see section 3.2 of this

²⁸ The waiting time is set at five years for sentences of up to three years of imprisonment and at 10 years for longer imprisonment.

paper). In the Macedonian central bank law, sole state ownership is explicitly stated, the Turkish legislation provides for a minimum of 51% state ownership, no provision on ownership can be found in the Bulgarian law. All three SEE central bank laws contain detailed provisions regulating the allocation of profits, only the Bulgarian and Macedonian legislation also contain provisions on the coverage of potential losses. Typically – and this is similar to the provisions found in other SEE countries (Dvorsky, 2004, p. 61) – a proportion of the profits has to be allocated to one or more (general and/or special) reserve funds to create a cushion for potential losses and to provide for a range of other predefined purposes. The residual amount has to be transferred to the state budget (annex, table 3). While the provisions on profit allocation are largely unproblematic in terms of CBI, the stipulated mechanisms for covering central bank losses may potentially involve a form of monetary financing. As a case in point, Article 89 of the Macedonian central bank law stipulates that the government may issue securities, which may temporarily be transferred to the central bank in case of central bank losses. These securities have to be redeemed from the central bank's profit in the following years. This latter provision implies a financial flow from the central bank to the state budget, which is regarded as potentially conflicting with the prohibition of direct central bank credit. Consequently, the "avis" on Macedonia calls for an amendment of the relevant legislation in this field (European Commission, 2005b, p. 91). The Bulgarian central bank law, which had contained a similar provision and was therefore criticized by last year's Progress Report (European Commission, 2004b, p. 79), has meanwhile been amended and is now in full compliance with the Treaty requirements. This progress was acknowledged by the Progress Report 2005 (European Commission, 2005a, p. 47). Similar – potentially problematic – provisions on loss coverage can be found in a number of other SEE central bank laws (Dvorsky, 2004, p. 62).

One of the cornerstones of CBI is the prohibition of monetary financing. There is general consensus that direct central bank lending to the government, be it in securitized or nonsecuritized form (i.e. advances or purchases of government papers on the primary market, overdraft facilities) has to be prohibited by law. Indirect credit, however, such as the acquisition of government securities on the secondary market, is generally not regarded as infringing CBI.²⁹ The main explanation behind the permission of indirect central bank credit is that on the secondary market, government papers are traded at market rates, thus making public and private sources of funding close substitutes (Radzyner and Riesinger, 1997, p. 69). Article 101 (1) of the Treaty, as restated in Article 21.1 of the Statute,

²⁹ This is specified by the Council Regulation (EC) No 3604/93, according to which the purchase of government securities on the secondary market is permitted, unless this could be regarded as a circumvention of the prohibition of monetary financing (Council Regulation (EC) No 3604/93, December 1993).

stipulates that “overdrafts or any other type of credit facility with the ECB or with the NCBs in favour of Community institutions or bodies, central governments, regional, local or other public authorities, other bodies governed by public law, or public undertakings of Member States shall be prohibited, as shall the purchase directly from them by the ECB or NCBs of debt instruments.” Complementary to the prohibition of direct central bank lending to the government, Article 102 (1) of the Treaty prohibits privileged access of public authorities³⁰ to financial institutions. The rationale of this provision is to prevent distortions of market economy principles (Häde, 2002, p. 1311). The Treaty does not contain a prohibition of indirect central bank credit.

All three central bank laws analyzed explicitly prohibit direct central bank lending (see annex, table 3). While in Bulgaria this prohibition also pertains to indirect central bank lending, the Macedonian legislation explicitly allows for purchases of government securities on the secondary market. However, Article 45.3 of the Bulgarian central bank law provides for one exception to this general prohibition of direct central bank credit, according to which the central bank may extend direct credit to the government for the purpose of purchasing Special Drawing Rights (SDRs) from the IMF under certain conditions. This provision was criticized by the Progress Report on Bulgaria in 2004³¹. Meanwhile, a special final provision was included into the amended law so that this provision will cease to exist from the date of Bulgaria’s EU accession (Grozev, in this volume). The Progress Report 2005 did not mention this issue anymore. The Macedonian central bank law contains a very similar provision (see Article 51 of the Law on the National Bank of the Republic of Macedonia), which might also require an adjustment of legislation in this area. The “avis” on Macedonia, however, remained silent on this issue. Although the Turkish central bank law explicitly prohibits any direct financing to the public sector, the Progress Report on Turkey finds that certain safeguards might be needed in respect of possible “lending of last resort” operations by the central bank in order to bring the central bank law fully in line with Article 101 of the Treaty (European Commission, 2004c, p. 106 and 2005d, p. 91). This criticism refers to Article 40 I b of the Turkish central bank law, according to which the central bank may grant advance to the Savings and Deposits Insurance Fund in exceptional circumstances (Yesiladali, in this volume, who also argues for an amendment in this area). While the Turkish and the Macedonian central bank legislation require some adaptations in the field of prohibition of budgetary financing by the central bank, the Bulgarian central bank law seems to

³⁰ According to Article 102 (2), this prohibition pertains to Community institutions or bodies, central governments, regional, local or other public authorities other bodies governed by public law, or public undertakings of Member States.

³¹ The Commission demanded a safeguard clause which limits this possibility to “obligations” vis-à-vis the IMF (European Commission, 2004b, p. 79).

be largely compatible with Treaty requirements, with a few details still to be adjusted to achieve full compatibility.

3.5 Central Bank Accountability

It is widely agreed 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 objectives of monetary policy (e.g. Bini Smaghi, 1998). Central bank accountability, as defined by the ECB, is the legal and political obligation of an independent central bank to justify and explain its decisions to the citizens and their elected representatives (ECB, 2002, p. 45). While there is ample literature on theory and evidence of central bank accountability (as a case in point, see Eijffinger and Hoeberichts, 2000), an in-depth analysis of accountability issues in SEE would go beyond the scope of this paper and leaves room for further studies. In order to complement the picture of current central bank legislation in SEE, the paper will touch upon the most important elements of accountability, namely forms of cooperation with the government, appearances before parliament, reporting requirements and the publication of minutes.

It is generally acknowledged that an efficient conduct of monetary policy should not be done in isolation, but should be coordinated in some way with the economic policies pursued by the government. However, the forms and intensity of regulating this cooperation in the respective central bank laws widely differs (see annex, table 4). A rather loose form of cooperation is the mutual information of central bank officials and politicians. As a case in point, the Bulgarian central bank law provides for an exchange of information between the central bank and the government on the formulation of the general outlines of the monetary policy. A slightly more intense form of cooperation is the consultation on selected issues, which is for instance stipulated in the central bank law of Turkey. Article 4 III of the Law on the Central Bank of the Republic of Turkey defines the bank as the financial and economic advisor of the government. In the former function, the bank may give opinions on the financial system, both on request of the government and by its own initiative. The latter function is regulated in Article 41 I, according to which the bank may submit opinions on money and credit policy on request of the government. An even closer form of cooperation is the mutual participation of central bank officials and politicians in meetings of decision-making bodies: As a case in point, Article 113 (1) of the Treaty stipulates that the “President of the Council and a member of the Commission may participate, without having the right to vote, in meetings of the Governing Council of the ECB.”³² Conversely,

³² In practice, it is the Ecofin Council President and the Commissioner for Economic and Monetary Affairs who participate in the ECB Governing Council’s meetings from time to time.

Article 113 (2) provides for participation of the ECB president in Council meetings when the Council discusses “matters relating to the objectives and tasks of the ESCB.” The central bank laws of Macedonia and Turkey provide for the participation of a representative of the finance ministry in the meetings of the highest decision-making body without a right to vote (see annex, table 4).

Provisions on the appearance of the central bank governor before parliament are considered very important, because these open the possibility of a dialogue between the central bank and elected representatives of the people. Article 113 (3) of the Treaty stipulates that the ECB president and other ECB executive board members can be heard by the European Parliament, at the request of the parliament, or on the initiative of the relevant parliamentary committees. Looking at the three SEE central bank laws examined, provisions on the relationship between the central bank and parliament largely differ (see annex, table 4). The Bulgarian law mentions that the central bank “reports its activities” to parliament. Similarly, the Macedonian law contains a general statement that the central bank has a “statutory accountability” to parliament, but – taking a closer look – Macedonian legislation assigns a very powerful role to the parliament, which in part goes beyond the generally acknowledged necessity of holding the central bank accountable. The Macedonian legislation requires the central bank governor to appear before parliament at least twice a year. Furthermore, the central bank has to submit the monetary policy objectives to parliament annually for the subsequent year. The latter provision potentially implies a very strong ex ante coordination of monetary policy with the parliament, which may jeopardize CBI and will have to be removed in order to comply with the Treaty. As already mentioned in section 3.2 of this paper, the Macedonian parliament even has a final say if the National Bank Council fails to reach the necessary majority for decision-making, a provision, which also will have to be removed to achieve compliance with the Maastricht requirements. Both the Bulgarian and the Turkish legislation provide for regularly informing the parliament on the central bank’s budget. As this is in both cases a mere ex-ante information, with the decisions being taken by the central bank’s decision-making bodies, these provisions do not seem to jeopardize the budgetary independence of the respective central banks.

The publication of regular reports enables the central bank to explain its policies and objectives and to review past performance. The fact that these reports are typically made available to interested parties free of charge³³ makes them easily accessible to the public (Smits, 1997, p. 175). The reporting requirements of the ECB are regulated by Article 113 (3) of the Treaty and Article 15.3 of the Statute, according to which “the ECB shall address an annual report on the activities of the ESCB and on the monetary policy of both the previous and the current year to the

³³ According to Article 15.4 of the Statute, the ECB’s publications have to be offered free of charge.

European Parliament, the Council and the Commission and also to the European Council.” This report has to be presented by the ECB President. Furthermore, the Statute contains additional reporting requirements, obliging the ECB to report at least quarterly on its activities (Article 15.1) and to publish a consolidated financial statement every week (Article 15.2). In the three SEE central bank laws, a broad variety of legislated reporting requirements can be found: While the Bulgarian and Macedonian legislation contain very detailed provisions in this area, the wording of the Turkish law is somewhat less precise on the timing and frequency of required reporting (see annex, table 4). In practice, all three central banks issue a lot more publications than required by law. The Bulgarian National Bank publishes – in addition to fulfilling its legislated reporting obligations – a Monthly Bulletin, three different quarterlies (Economic Review, Government Securities Market and Commercial Banks in Bulgaria) and an Annual Report.³⁴ The publications of the National Bank of the Republic of Macedonia comprise the legally required semiannual and annual reports as well as Monthly Informations and Quarterly Reports.³⁵ The Central Bank of the Republic of Turkey issues a broad range of periodic publications, including inter alia Annual Reports, quarterly Monetary Policy Reports and Quarterly Bulletins as well as a number of monthly publications.³⁶

The question whether just the outcome or the detailed minutes of the meetings of the highest decision-making body are published is related to the issue of individual versus collective accountability (Bini Smaghi, 1998). In the case of the ECB, the ECB Governing Council is held accountable collectively: According to Article 10.4 of the Statute, the proceedings of the ECB Governing Council meetings are confidential. The Governing Council, however, may decide to make the outcome of the deliberations public. None of the laws examined contains a provision on a possible publication of the minutes of the highest decision-making body.³⁷

4. Conclusions

Reviewing central bank legislation in Bulgaria, Macedonia and Turkey, considerable progress has been achieved by all three countries. Analyzing the different aspects of CBI in detail, the picture that emerges is quite mixed and clearly corresponds to the state of integration of the respective country with the European Union.

³⁴ See <http://www.bnb.bg>, retrieved on September 23, 2005.

³⁵ See <http://www.nbrm.gov.mk>, retrieved on September 23, 2005.

³⁶ See <http://www.tcmb.gov.tr>, retrieved on September 23, 2005.

³⁷ Interestingly, the laws of Albania and Bosnia and Herzegovina largely resemble the stipulation of the Statute in this area (Dvorsky, 2004, p. 65).

In the field of functional independence, legislated primary objectives are fully in line with Treaty requirements in Bulgaria, while some adaptations will be needed in the Macedonian and Turkish legislation in the area of secondary objectives. As regards institutional independence, Bulgaria's law largely complies with the Treaty requirements, whereas substantial adjustments will be necessary in the cases of Macedonia and Turkey. The main area of legislation potentially jeopardizing the central banks' independence to design and implement monetary policy is the possibility of a disagreement within the central banks' highest decision-making body, where casting votes are assigned to the prime minister (in the case of Turkey) or to the parliament (in the case of Macedonia). Furthermore, the Turkish legislation stipulates that the inflation target is determined jointly by the central bank and the government. In the area of personal independence, the main weakness can be found in the provisions on the reasons for dismissal of central bank top officials. As to financial independence, all three central bank laws provide that the central bank's budget is managed by the bank independently from any government institution. Furthermore, direct central bank credit is prohibited in all countries examined. Adaptations will be required for provisions on loss coverage – an issue which is closely linked to the prohibition of direct central bank credit – in the case of Macedonia. For the Turkish law, safeguards might be needed in respect of possible “lending of last resort” operations of the central bank.

As to central bank accountability, the main elements are in place in all three central bank laws examined, comprising different forms of cooperation between central banks and the respective governments, legislated appearances before the parliament and regular reporting requirements. However, parts of the Macedonian and Turkish legislation go beyond the generally acknowledged necessity of holding the central bank accountable and can be regarded as potentially infringing CBI.

To sum up, the Bulgarian central bank legislation seems largely ready for EU accession, while a number of substantial adaptations will be necessary for Macedonia and Turkey to fulfill the requirements of the Treaty.

References

- Bini Smaghi, L. 1998.** The Democratic Accountability of the European Central Bank. *Banca Nazionale del Lavoro Quarterly Review* 205. June. 119–143.
- Central Bank of Turkey. 2005.** General Framework of Inflation Targeting Regime and Monetary and Exchange Rate Policy for 2006. December 5.
- Council of the European Union. 1999.** Presidency Conclusions. Helsinki. December 10 and 11.
- Council of the European Union. 2004a.** Presidency Conclusions. June 17–18.
- Council of the European Union. 2004b.** Presidency Conclusions. Brussels. December 16 and 17.

- Council of the European Union. 2005.** Presidency Conclusions. December 15–16.
- Council Regulation (EC) No 3604/93. 1993.** specifying definitions for the application of the prohibition of privileged access referred to in Article 104a of the Treaty. Official Journal L 332 , 31/12/1993 P. December 13.
- Cukierman, A. 1992.** Central Bank Strategy, Credibility and Independence: Theory and Evidence. MIT Press. Cambridge. 371–455.
- Cukierman, A., G. Miller and B. Neyapti. 2000.** Central Bank Reform, Liberalization and Inflation in Transition Economies – An International Perspective. July.
- Dvorsky, S., P. Backé and O. Radzyner. 1998.** The 1998 Reports of the European Commission on Progress by Candidate Countries from Central and Eastern Europe: The Second Qualifying Round. Focus on Transition 2. Vienna: Oesterreichische Nationalbank. 38–114.
- Dvorsky, S. 2000.** Measuring Central Bank Independence in Selected Transition Countries and the Disinflation Process. BOFIT Discussion Paper 13.
- Dvorsky, S. 2004.** Central Bank Independence in Southeastern Europe with a View to Future EU Accession. Focus on European Economic Integration 2. Vienna: Oesterreichische Nationalbank. 50–75.
- Eijffinger, S. C. W. and M. M. Hoeberichts. 2000.** Central Bank Accountability and Transparency: Theory and Some Evidence. Discussion Paper 6/00. Economic Research Centre of the Deutsche Bundesbank. November.
- European Central Bank. 2002.** The Accountability of the ECB. In: ECB Monthly Bulletin. November. 45–57.
- European Central Bank. 2004.** Convergence Report 2004.
- European Commission. 2004a.** The Stabilisation and Association process for South East Europe. Third Annual Report. March 30.
- European Commission. 2004b.** Regular Report on Bulgaria’s Progress towards Accession. October 6.
- European Commission. 2004c.** Regular Report on Turkey’s progress towards Accession. October 6.
- European Commission. 2004d.** Convergence Report 2004. October 20.
- European Commission. 2004e.** Convergence Report 2004 – Technical Annex. October 20.
- European Commission. 2005a.** Bulgaria 2005 Comprehensive Monitoring Report. October 25.
- European Commission. 2005b.** Analytical Report for the Opinion on the Application from the Former Yugoslav Republic of Macedonia for EU Membership. November 9.
- European Commission. 2005c.** Commission Opinion on the Application from the Former Yugoslav Republic of Macedonia for Membership of the European Union. November 9.

- European Commission. 2005d.** Turkey 2005 Progress Report. November 9.
- European Monetary Institute. 1996.** Progress towards Convergence. November. 100–142.
- Freytag, A. 2003.** Central Bank Independence in Central and Eastern Europe on the Eve of EU Enlargement. Occasional Paper 4. Institute for Economic Research. Ljubljana. August.
- Grilli, V., D. Masciandaro and G. Tabellini. 1991.** Political and Monetary Institutions and Public Financial Policies in the Industrial Countries. Economic Policy. October 341–392.
- Häde, U. 2002.** In: Calliess C. and Ruffert M. Kommentar des Vertrages über die Europäische Union und des Vertrages zur Gründung der Europäischen Gemeinschaft. 1308–1313.
- Ilieva, J. and N. Healey. 2001.** Measures and Patterns of Central Bank Independence in Transition Economies. Statistics in Transition 5(1) March. 151–166.
- Law on the Bulgarian National Bank. 1997.** June 10. Most Recently Amended in 2005.
- Law on the Central Bank of the Republic of Turkey. No.1211. 1970.** January 14. Most Recently Amended in 2001.
- Law on the National Bank of the Republic of Macedonia. 2002.**
- Maliszewski, W. 2000.** Central Bank Independence in Transition Economies. Economics of Transition 8(3). 749–789.
- Neumann, M. 1991.** Precommitment by Central Bank Independence. In: Open Economics Review 2. 95–112.
- Protocol Concerning the Conditions and Arrangements for Admission of the Republic of Bulgaria and Romania to the European Union. 2005.** April 2005.
- Protocol on the Statute of the European System of Central Banks and of the European Central Bank. 1992.**
- Radzyner, O. and S. Riesinger. 1997.** Central Bank Independence in Transition: Legislation and Reality in Central and Eastern Europe. Focus on Transition 1. Vienna: Oesterreichische Nationalbank. 57–90.
- Smits, R. 1997.** The European Central Bank. Institutional Aspects. London: Kluwer Law International. 151–221.
- Swinburne, M. and M. Castello-Branco. 1991.** Central Bank Independence: Issues and Experience. IMF Working Paper 91/58. June.
- Treaty Establishing the European Communities. 1957.** As amended by the Treaty on European Union of Maastricht (1992) and the Treaty of Amsterdam (1997).

Annex

Table 1: Statutory Objectives and Formulation and Implementation of Monetary Policy

Central Bank	Statutory Objectives – Functional Independence	Formulation and Implementation of Monetary Policy – Institutional Independence
Bulgarian National Bank	<ul style="list-style-type: none"> *“...to maintain price stability...” (Article 2.1) *without prejudice to the primary objective, the Bank shall support general economic policies in the EU, upon Bulgaria's EU accession (Article 2.2) 	<ul style="list-style-type: none"> *freedom from instructions (Article 44) *detailed definition of currency board regime (Article 28) *fixed exchange rate (Article 29)
National Bank of the Republic of Macedonia	<ul style="list-style-type: none"> *“...to maintain price stability” (Article 3) *the Bank shall support economic policy and financial stability without jeopardizing main objective (Article 3) 	<ul style="list-style-type: none"> *freedom from instructions (Article 4) *the bank shall “establish and conduct the monetary policy” (Article 10) *in case of lack of consent by the National Bank Council, final decision is taken by parliament (Article 67) *the Bank shall “establish and conduct exchange rate policy” (Articles 10 and 20)
Central Bank of the Republic of Turkey	<ul style="list-style-type: none"> *“...to achieve and maintain price stability” (Article 4) *the Bank shall support growth and employment policies if this is not in conflict with primary objective (Article 4) 	<ul style="list-style-type: none"> *“...determine and implement monetary policy” (Article 4) *“the Bank shall determine the inflation target together with the Government...” (Article 4 II b) *monetary Policy Committee establishes exchange rate policy jointly with the Government (Article 22A d) *in case of disagreement between governor and Board, the Prime Minister shall act as an arbitrator (Article 26.3)

Source: Law on the Bulgarian National Bank. 1997. June 10. Amended in 2005. Law on the Central Bank of the Republic of Turkey. No. 1211. 1970. January 14. Amended in 2001.

Law on the National Bank of the Republic of Macedonia. 2002.

Table 2: Personal Independence of Central Banks

	Governor		Highest Decision-Making Body		Dismissal	Incompatibility Clauses
	Term	Appointment	Composition; Term	Appointment		
Bulgarian National Bank	*6 years (Article 12.4)	*elected by parliament (Article 12.1)	*Governing Council: Governor, 3 Deputy Governors, 3 other members (Article 11.1) *term: 6 years (Article 12.4)	*3 Deputy Governors elected by parliament, on Governor's proposal (Article 12.2) *other 3 members appointed by president of state (Article 12.3)	*inability to perform functions for more than six months *serious misconduct *non-fulfilment of incompatibility clauses of Article 11.4 (Article 14.1)	*Governor and Deputy Governor shall not perform any other remunerated activity (Article 12.5) *other 3 members: no other activity at the BNB or other financial institutions, no activity in the executive branch (Article 12.6)
National Bank of the Republic of Macedonia	*7 years, one reappointment possible (Article 70)	*appointed by parliament, on proposal of state president (Article 70)	*National Bank Council: Governor, 2 Vice Governors, 6 members (Article 57) *term: 7 years (Article 60, Article 72)	*Vice Governors appointed by parliament on proposal of Governor, one reappointment possible (Article 72) *other members appointed by parliament on proposal of state president, no reappointment (Article 60)	*criminal act *ban on practicing profession *illness *inability *performing functions dishonestly, unprofessionally, etc. (Article 70)	NBC membership incompatible with, i.a. (Article 58): *position in commercial banks *trade union membership *net debtor of a bank status *criminal sentence (waiting time) *party membership
Central Bank of the Republic of Turkey	*5 years, reappointment possible (Article 25)	*appointed by a decree of the Council of Ministers (Article 25)	*Monetary Policy Committee: Governor, 4 Vice Governors, 1 Board member, 1 other member (Article 22A) *term: 5 years Vice Governors (Article 29); 5 years other member (Article 22A), 3 years Board member (Article 20)	*Vice Governors appointed by joint decree on recommendation of Governor, reappointment possible (Article 29) *Board member: elected by Board members (Article 22A) *other member: appointed by joint decree on recommendation of Governor (Article 22 A)	*in cases of violation of incompatibility clauses (Article 28) *inability to perform duties (Article 28)	*Governor shall not perform any other duty outside the Bank of a legislative, official or private nature (Article 27) *Board member and other member: similar provisions in Article 19

Source: Law on the Bulgarian National Bank. 1997. June 10. Amended in 2005.
Law on the Central Bank of the Republic of Turkey. No. 1211. 1970. January 14. Amended in 2001.
Law on the National Bank of the Republic of Macedonia. 2002.

Table 3: Financial Independence of Central Banks

	Limits to Government Lending		Budgetary Independence		Coverage of Potential Losses
	Direct Credit	Indirect Credit	Ownership, Management of Budget	Allocation of Profit	
Bulgarian National Bank	prohibited (Article 45.1)		<ul style="list-style-type: none"> * approval of annual budget by Governing Council (Article 16.13) * the bank addresses the approved annual budget to parliament (Article 50) 	<ul style="list-style-type: none"> * 25% of profits allocated to reserve fund (Article 8.2) * necessary amounts to be allocated to special funds (Article 8.3) * residual to state budget (Article 8.4) 	<ul style="list-style-type: none"> * losses covered by reserve fund, special fund (Article 9.2) * residual covered by Ministry of Finance (Article 9.1)
National Bank of the Republic of Macedonia	prohibited (Article 51)	purchases of government securities in the secondary market permitted (Article 89)	<ul style="list-style-type: none"> * sole state ownership (Article 5) * National Bank Council adopts financial plan (Article 64.4) 	<ul style="list-style-type: none"> * 20% of net income allocated to general reserves (Article 86) * residual to state budget (Article 89) 	<ul style="list-style-type: none"> * losses covered by general reserves * residual covered by state budget (Article 89)
Central Bank of the Republic of Turkey	prohibited (Article 56)		<ul style="list-style-type: none"> * joint stock company (Article 1), minimum of 51% owned by Treasury (Article 8) * budget prepared by the Board (Article 22i) * Prime minister may have operations audited (Article 42) 	<ul style="list-style-type: none"> * 20% to reserve fund * 6% first dividend * max. of 5% to personnel * 10% to extraordinary reserve fund * max. of 6% second dividend (Article 60a-d) 	<ul style="list-style-type: none"> no provisions

Source: Law on the Bulgarian National Bank. 1997. June 10. Amended in 2005.
 Law on the Central Bank of the Republic of Turkey. No. 1211. 1970. January 14. Amended in 2001.
 Law on the National Bank of the Republic of Macedonia. 2002.

Table 4: Central Bank Accountability

	Forms of Cooperation with Government	Relationship with Parliament	Reporting Requirements
Bulgarian National Bank	*mutual information (Article 3)	*the Bank shall “report its activities” before parliament (Article 1.2) *the Bank addresses approved annual budget to parliament (Article 50)	*weekly publication of balance sheet (Article 49.1) *monthly publication of balance sheet (Article 49.2) *the bank submits two reports per year on the Bank’s activities to parliament (Articles 50 and 51)
National Bank of the Republic of Macedonia	*Minister of Finance may attend meetings of National Bank Council, but has no right to vote (Article 63)	*the National Bank Council is responsible to parliament (Articles 61, 74) *parliamentary committees meet with Governor at least once every 6 months (Article 55a) *decision on monetary policy objectives has to be submitted to parliament (Article 54)	*semiannual and annual reports to parliament on operations, supervision and foreign reserve management (Article 55.1–55.3)
Central Bank of the Republic of Turkey	*the bank may give opinion on money and credit policy, on request of government (Article 41 I) *the bank may give opinion on financial system, own initiative or on request of government (Article 4 III a-c) *Undersecretary of Treasury of Deputy may participate in Monetary Policy Committee, without voting right (Article 22A) *Governor submits two reports per year on operations and monetary policy to the Council of Ministers (Article 42) *the bank submits written information to the government and to the public on the reasons of incapability to achieve targets (Article 42)	*the bank submits information on operations to the Planning and Budget Commission of parliament twice a year (Article 42)	*the bank prepares periodical reports on monetary policy targets and implementations to public (Article 42) *the bank issues a weekly bulletin on statement of accounts (Article 63)

*Source: Law on the Bulgarian National Bank. 1997. June 10. Amended in 2005.
Law on the Central Bank of the Republic of Turkey. No. 1211. 1970. January 14. Amended in 2001.
Law on the National Bank of the Republic of Macedonia. 2002.*

Strengthening the Guarantees for Independence of a Central Bank in Compliance with EU Requirements: The Case of Bulgaria

Rossen Grozev¹

Balgarska Narodna Banka

1. Introduction

The objective of this paper is to analyze the regulative developments concerning central bank status in a country acceding to the European Union (EU). Trying to assess impartially the challenges faced by the Bulgarian legislator in the process of elaborating legal guarantees for the independence of the Balgarska Narodna Banka (BNB), the present work will outline both the internal and the external context of the reform. They are represented respectively by the existing legislation relating to the central bank and by the common standard, established through the legal framework of the EU, as well as through its reflection in national legislative acts of the EU Member States. After briefly explaining the juridical developments with respect to the BNB during the last decade, the research will compare the provisions in the several topical areas before and after their revisions – norms concerning the basic goal of the central bank, its institutional, functional, personal and financial independence. The additional improvements of the legal framework will be also briefly presented.

The inspiration for this research is partially generated by the recent and successful completion of the legislative reform regarding the BNB, as reflected in the extensive amendments of the Law on the Balgarska Narodna Banka dating from January 2005. Another reason was the need to investigate a curious example of central bank legislation which already demonstrated a high degree of compliance with the independence standards established by the Statute of the European System of Central Banks (ESCB Statute), but which has reached this

¹ The views expressed in this paper are only those of its author. They do not engage in any way the position of any official institution in Bulgaria or abroad. Any error is also responsibility of the author.

result in its own way, long before the imperatives of EU integration imposed the necessity to implement directly the relevant provisions. Nevertheless, despite the result already being in place, the reform proved necessary as a basis for the formal assessment of compliance and as convincing conclusion of continuous efforts for achieving real autonomy. This paper explains the dilemmas faced by the legislator, but aims at something more than simple presentation of facts or defense of a particular chosen approach. The purpose of such research is to show in somewhat different light the tenets of central bank independence and to convince that the best way towards its achievement is to create a pragmatic mechanism, that in advance naturally leads to autonomy, instead of imposing it as just another mandatory element of the EU “*acquis communautaire*”.

2. The Concept of Independence

A substantial element of the juridical basis allowing the accession to the Economic and Monetary Union is guaranteeing the independence of the central bank. This independence is usually perceived as represented by four basic elements – institutional, functional, personal and financial independence.

The institutional independence refers to the position of a national central bank within the institutional framework in the respective country, including its relationships with government bodies, private entities and international (or supra-national) bodies (Deller, 1999).

The functional dimension of independence includes the autonomy of the central bank to choose its own policy and instruments allowing the achievement of the objectives set forth by the statutory law (Muehring, 1991).

The requirement for personal independence concerns the issues connected to the appointment of the highest officials of the central bank, the duration of their mandate, the conditions for their dismissal.

Finally, as Deller (1999) underlines, the whole concept of independence as a generic notion would be worthless, if national central banks were not granted the financial means to operate autonomously in order to fulfill their mandate. According to the 1996 Convergence Report of the European Monetary Institute (“Progress towards Convergence 1996”), all national central banks within the EU “should be in a position to avail themselves of the appropriate means to ensure that their ESCB-related tasks can be properly fulfilled”.

Instead of “independence”, other authors prefer the term “autonomy”. Although Hidalgo (2003) rightly points out that in most works on the subject the terms “independence” and “autonomy” are used interchangeably, there are researchers who distinguish between the two terms, linking autonomy to the central bank’s operational freedom, and independence to the lack of institutional constraints (IMF, 1998). In this way, on the level of the EU terminology, “autonomy” seems covered

by the notion of “functional independence” and “independence” (in the narrow sense) – by “institutional independence”.

At the same time, “functional independence” is understood by some authors not as just one of the four equally important dimensions of central bank’s independence, but as a generic notion, characterizing the whole concept of that independence. Brentford (1999) defines the functional autonomy of the ECB on the basis of its tasks and competencies, given to it in order to fulfil those tasks. The author perceives the autonomy of the ECB personnel, its financial autonomy and its regulatory independence not as equally important features of the more general concept of “independence”, but as building together the *functional independence* of the ECB. The same line of argumentation is followed presumably by the European Court of Justice, seized to decide in the case “Commission of the European Communities v. European Central Bank” (C-11/00) whether the ECB was subject to Community law, whether it fell within the notion of “institutions, bodies, offices and agencies established by, or on the basis of, the Treaties” (the wording of Regulation 1073/1999) and, accordingly, whether the ECB should cooperate with the established through the same Regulation European Anti-Fraud Office (OLAF), instead of leaving the fight against fraud within the exclusive competence of its own fraud investigation department. Upholding the view of the European Commission, the Court of Justice accepted the independence of the ECB as guaranteed by Art. 108 of the Treaty, but underlined that this does not imply a complete independence from the Community law. The Court understands the independence of the ECB as a functional one, determined by the extent to which the proper execution of ECB tasks as per Art. 105 of the Treaty requires the protection of its independence from external influences. Consequently, the ECB’s independence is not complete and absolute, but a limited, functional one – its scope being defined by what is needed for isolation from external pressures of the decisions related to the achievement of price stability (Lavranos, 2004).

Thus “functional independence” becomes something more than one of the four building components of “independence” as a generic notion and is perceived already as the main characteristic, the very substance of that independence. Especially interesting in this regard seems the classification of central bank’s independence, proposed by Advocate General Jacobs in his opinion, given in the context of Case C-11/00. Advocate General Jacobs explained the notion of ECB independence by dividing it into three main areas: institutional, personal and financial (“functional” is already perceived not as a different kind of independence, but as the general notion, comprising the three areas). The institutional aspect is embodied in ECB’s distinct legal personality, decision-making freedom, legislative ability, and its power over its internal organization. The personal independence is determined by the rules governing the appointment of the members of the Executive Board and Governing Council, the security of tenure of these members and the norms preventing potential conflict of interests by engaging in external

activities. The financial independence of the ECB consists in its control over its own budget, which is audited by independent external auditors who are limited to examining only the operational efficiency of the ECB management (Reader, 2004). Although referring to the scope of autonomy of the ECB, the extensive enumeration of the components of independence is applicable to all central banks in the EU, since they generally follow the ECB's model, with the possible exception of Sveriges Riksbank, where the refusal to make the central bank legally independent – satisfying in this way the Treaty-based criterion for joining the Economic and Monetary Union – is used as a formal pretext for not adopting the Euro despite the eventual fulfillment of convergence criteria, since Sweden was not granted an “opt out” clause, but its population rejected the common currency on the 2003 referendum (Goebel, 1998).

Of course, one could support the view that the proper fulfillment of the tasks under Art. 105 of the Treaty would be impossible without a complete independence from the Community legislature and thus isolation from Community law, otherwise the aim of price stability could not be achieved by the ECB. That is why Zilioli and Selmayer (1999) maintain that “the ECB is not a Community institution, but a separate and autonomous entity which, though linked with the Community, rather constitutes a “Community of its own”, a “Community within the Community”; this makes the ECB an autonomous specialized organization of Community law”. An additional argument adduced by the same authors in 2000, stresses upon the fact that when defining the independence of the ECB, Art. 108 of the Treaty does not provide any exceptions or restraints.

Apart from the heated discussion over the exact scope of independence granted to the ECB, the available classifications of central bank autonomy vary at least as much as the number of authors engaged in the research of this topic, which proved to be quite attractive since the beginning of the last decade. For instance, Grilli, Masciandaro and Tabellini (1991) draw the line between “political independence” (represented by the power of the central bank to select policy objectives without government influence) and “economic independence” (allowing the central bank to utilize the whole spectrum of monetary policy instruments, and supported by the limits on the government's access to central bank credit). Others prefer to differentiate in the same context between “goal independence” and “instruments independence” (Fisher and Debelle, 1994).

Cecchetti (1999) is more inclined to speak about different ways of assessing independence, instead of about different kinds, or dimensions of “independence”. Thus, one way for assessing independence as a unified generic notion will be to determine the extent to which the central bank is free from the government in formulating and implementing its policies; another way will be to investigate the existing procedures for nomination and dismissal of the central bank managers. Still another way is to explore the extent of central banks' financial autonomy, which naturally is greatest where the central bank is self-financing and/or an

autonomous corporate entity. On the other hand, Alesina and Summers (1993) quantified the independence of central banks by creating an index of various factors, including: how the formation of the board of a central bank is determined; to what extent the bank is accountable to legislative authorities; whether the legislation creating the central bank specifically addresses price stability.

On the background of all these classifications, one is tempted to accept the broad and succinct – although not necessarily strict in juridical sense – definition of Hidalgo (2003) that “central bank independence” may be understood as a legal and institutional arrangement that allows monetary authorities to adopt policy decisions and operational procedures aimed at achieving price stability apart from the government and private sector’s interests.

3. Juridical Framework with Regard to the BNB after the Systemic Crisis of 1996–1997

Approaching the topic of legal developments concerning the BNB during the last 15 years and the closely related issue of systemic crisis in the banking sphere, a literary analogy comes to mind. One of the greatest 20th century’s novels – “Conversation in the Cathedral” by Mario Vargas Llosa – begins with the following scene: the protagonist stays on the street in a Latin American country (not Argentina indeed, but Peru) and asks himself: “When exactly I failed? When this country failed?” These two questions reappear constantly in the next 600 pages of the novel, in order to illustrate that the small failures of each person are inextricably intertwined with the general downfall of the state where he or she lives. The same truth is valid with respect to the central banks in all countries that have had the unenviable experience to taste a systemic crisis. Always the central bank should analyze in detail its own behavior, its own compromises, if trying to understand the roots of the State’s problems. The solutions are especially interesting – they illustrate the simple maxim that the disciplined, strongly independent and responsible central bank is instrumental in overcoming systemic crises and preventing them.

The currency board arrangement in Bulgaria was introduced after several hesitant attempts to stabilize the economy during the first stage of transition (1991–1996) and after a severe systemic crisis, which led to the brief hyperinflationary episode of December 1996–February 1997. As Balyozov (1999) points out, in the course of those efforts every nominal anchor – with one exception – was employed unsuccessfully, the policy of stabilization was eroded and all institutions lost their credibility. The boldest solution was to introduce the only remaining nominal anchor (the exchange rate), to design a “new” institution (a currency board), to gain credibility by transferring monetary sovereignty abroad, and – for the International Monetary Fund (IMF), which has seen its own prestige eroded – to support a different model of action. The currency board arrangement was a deliberate choice

and an intentional limitation in the functions of the BNB. But, paradoxically, a greater autonomy was attained at the cost of the amputation of several of the “classical” functions of the monetary authority, as Balyozov (1999) underlines.

Following the bitter lessons from extending credits to the government and state-owned enterprises, in 1997 the Bulgarian banking system adopted in its most orthodox version the basic principle for prohibition of monetary financing and privileged access of the State and any state agency. Pursuant to the currency board mechanism, the aggregate amount of monetary liabilities of the Balgarska Narodna Banka must not exceed the lev equivalent of the gross international foreign exchange reserves. According to Art. 29 (1) of the Law on the Bulgarian National Bank (LBNB) in its 1997 version, the official exchange rate of the lev to the German mark was fixed as BGL 1000 per DEM 1. With the denomination of the lev in 1999, the exchange rate became 1 BGN (“new Bulgarian lev”) per 1 DEM.

A key moment for the functioning of the currency board system is the obligation of the BNB to sell and purchase on demand Euros against levs up to any amount within the territory of Bulgaria on the basis of spot exchange rates, which should not depart from the official exchange rate by more than 0.5 percent, inclusive of any fees, commissions and other charges to the customer (Art. 30 LBNB). Pursuant to Art. 29 (2) LBNB, when the euro was introduced as legal tender in the Federal Republic of Germany, the official exchange rate of the lev to the euro was determined by reflecting the official exchange rate of conversion of the German mark to the euro. That is why at the moment the fixed exchanged rate is 1 euro per 1.95583 levs.

The currency board arrangement of 1997 significantly restricted the monetary policy operations of the central bank. Art. 32 LBNB contains an exclusive list of transactions that the Bulgarian central bank may carry on. These transactions include credit operations against collateral; precious metals operations; foreign exchange operations; deposit and financial investment operations; operations connected with the payments turnover; commission operations; cross-border bank operations. This clause is complemented with the provision of Art. 37 LBNB, stipulating that the BNB may:

- a) buy and sell gold specie and bullion or other precious metals;
- b) buy, sell or contract deals in foreign currencies using to this end all customary means;
- c) open and maintain accounts with international financial institutions, central banks and other financial institutions outside Bulgaria;
- d) open and maintain accounts or act as a representative or correspondent of international financial institutions, central banks and other financial institutions outside Bulgaria.

One of the basic features of the Bulgarian currency board system is the prohibition for the central bank to extend credits to commercial banks (Art. 33, Par. 1 LBNB). The only exception to this rule is connected with the emergence of liquidity risk

that may affect the stability of the banking system. In this case the BNB may extend a credit, but only upon the simultaneous presence of five conditions:

- a) the recipient bank must be solvent;
- b) the credit is to be lev-denominated;
- c) the maturity of the emergency credit cannot exceed 3 months;
- d) the credit should be fully collateralized by gold, foreign currency or other such high-liquid assets;
- e) such credits may be extended solely up to the amount of the excess of the lev equivalent of the gross international foreign exchange reserves over the total amount of monetary liabilities of the central bank.

The procedure for extension of such credits is determined through Regulation No. 6 on Extending Collateralized Lev Loans to Banks. On the first place, this Regulation provides strict criteria for establishing the existence of a liquidity risk as a necessary precondition for extending loans. Several rules are then devoted to the regime of collateral. The BNB is allowed to accept as collateral against its lev loans to banks only:

- a) monetary gold;
- b) foreign currency – euros, U.S. dollars, or Swiss francs (deposited on a special account with the BNB, which is to be blocked until the collateralized claim is fully repaid, and the pledgor has no right to dispose with the amount deposited);
- c) paper or book-entry liquid securities issued by the Government of the Republic of Bulgaria, or guaranteed by it (the book-entry securities are to be blocked on the register maintained until the collateralized claim is fully repaid, and the pledgor has no right to dispose with them);
- d) prime-rate liquid securities issued by foreign governments and central banks, or guaranteed by them.

The pledged items and securities have to be submitted to the BNB which has the right to hold them until the collateralized claim is fully repaid.

The total amount of the assets pledged as collateral and assessed at their market value must cover at least 125% of the loan amount approved by the BNB at the time of its extension. If the submitted collateral becomes insufficient, as its market value falls below 105% of the bank's total obligation on the extended loan, the credited bank is obliged to supplement it within 3 days. If the bank defaults on this duty, without at the same time repaying the relevant part of the loan, the BNB may call the loan and proceed to its collection, including through the sale of the collateral without interference of a court of law. The way to this shortened procedure is paved by the clause of Art. 34 LBNB, which stipulates that in the event of the default in the repayment of any collateralized credit, the central bank shall have the right to sell the collateral as received without litigation. The sale proceeds are expected to cover the BNB's claims as regards the credit principal, interest and costs.

As a whole, Regulation No. 6 adopts quite a stringent regime for extending loans to commercial banks – a natural solution, stemming from the basic mechanism of the currency board system, with its requirement for a great discipline in using credit facilities by the central bank. The procedure contains a motivated written application by the troubled commercial bank, addressed to the Deputy Governor heading the Banking Department of the BNB. The application must be accompanied by information on the current financial status of the bank. The application is brought to the attention of the Banking Supervision Department of the BNB, which has to present a written statement of opinion on the current solvency of the bank within 24 hours. Finally, the decision on the loan application is to be made by the Managing Board of the BNB. In the event of approval, a loan contract is concluded.

In the final analysis, despite this role of a lender of last resort, assumed by the BNB, in principle commercial banks are expected to borrow funds on the interbank money market, because in a situation of sudden liquidity crisis (e.g. occurring in the context of participation in the payments systems) the bank cannot afford to be exclusively dependent on the cumbersome mechanism described – that is probably the explanation why it has never been used since the introduction of the currency board in 1997.

Apart from extending collateralized credits to commercial banks in the case of liquidity risk, the BNB may at present conduct its monetary policy through the classical instrument of minimum reserve requirements, as a lever for regulating the money supply. The use of the other two tools for achieving this goal through influence over banking reserves – open market operations and the “discount window” crediting – is quite restricted due to the currency board system. Prior to June 1997, the BNB had implemented its monetary policy through open market operations (repo and reverse repo agreements), outright sales and purchases of government securities, Lombard loans, the discount window and minimum required reserves.

Art. 41 LBNB gives the BNB the power to determine by a regulation the minimum reserve requirements which banks are required to keep with the BNB, the method of their calculation, as well as the terms and procedures for interest payment on them. Following this normative delegation, the BNB has issued Regulation N 21 on the Minimum Required Reserves Maintained with the Balgarska Narodna Banka by Banks. The use of a Regulation as a legal tool provides space for considerable flexibility in applying the minimum reserve requirements.

Banks may use the funds on their current accounts on particular days without limitation, since the minimum required reserves should be fulfilled on an average monthly basis. However, overdrafts on the current accounts are not allowed.

With regard to the foreign exchange management, the LBNB explicitly defines the composition of the gross international foreign exchange reserves of the BNB.

They are equal to the market value of several kinds of Bank's assets, enumerated in Art. 28, Par. 3 /1-6/. The BNB may take any necessary action in connection with the acquisition, possession and sale of these assets. Their investment should be in accordance with the principles and practices of prudent investment. Investments in securities are limited to liquid debt instruments, which are issued by foreign countries, central banks, other financial institutions or international financial organizations, whose obligations are assigned one of the two highest ratings by two internationally recognized credit rating agencies, and which are payable in freely convertible foreign currency. Of great importance is the rule that the market value of the assets denominated in foreign currency other than the euro, which is included in the gross international foreign exchange reserves, cannot exceed by more than two percent the total amount of monetary liabilities of the central bank denominated in the said currency and respectively cannot be less than two percent of these liabilities.

The LBNB provides that the total amount of the liabilities on loans drawn by the BNB, which are denominated and payable in foreign currency, could not be increased if this increase would result in an amount in excess of 10% of the assets of the BNB as reported in the last balance sheet. This restriction is not applicable to any change in the amount of liabilities of the BNB to the International Monetary Fund.

With the coming into force of the new Foreign Exchange Law (2000) Art. 10. Par. 1 of the Law on the Contracts and Obligations was repealed, making contracting and payments in any other currency in addition to the lev legally possible. The policy of the BNB has ever been directed towards encouragement of concluding contracts and executing payments in the national currency on the territory of the country. That is determined by the stability of the currency and the currency board arrangements. Nevertheless, since the beginning of 2000 contracting and payment in any currency is allowed, if both parties consent to this. However, if the common consent is lacking, no person could be forced to accept payment in any other currency except the lev. That follows from the unambiguous statement of Art. 25, Par. 2 LBNB – the banknotes and coins issued by the BNB are legal tender and obligatorily and without any restrictions accepted as payment at their full face value.

The systemic crisis of 1996 proved the immense importance of duly and impartially exercised banking supervision. In Bulgaria the supervision of the banking system is concentrated within the scope of the central bank. One of its three basic departments is dealing exclusively with banking supervision. This department is headed by a Deputy Governor, elected by the Parliament on a motion by the Governor. The term of office of the Deputy Governor responsible for banking supervision is six years, like the term of all the other members of the Managing Board of the BNB. Although the Banking Supervision Department is within the structure of the central bank, the Deputy Governor is quite independent

in applying – separately and at his/her own discretion – the remedy actions and penalties as provided for by the Law on Banks. The granting and revoking of a bank license, however, requires a decision by the Governor. The motion for issuing such a decision should originate from the Deputy Governor, responsible for banking supervision.

The first stage of exercising the functions of banking supervision is the granting of a written permit for conducting bank activities. In addition, a written permission from the central bank is required if a local or foreign person, as well as related persons, is going to acquire in a local bank directly or indirectly shares assuring control over ten or more than 10% of all voting shares.

The central bank possesses wide prerogatives for gathering information. According to Art. 2, Par. 3 of the Law on the BNB, the central bank regulates and supervises other banks' activities in Bulgaria for the purpose of ensuring the stability of the banking system and protecting depositors' interests. In connection with the performance of its functions, the BNB may demand from banks to submit any documents and information, and may also carry out the requisite examinations (Art. 4, Par. 1 LBNB).

This provision is elaborated through the rules of Art. 62 of the Law on Banks. It stipulates that the central bank supervises the activities of the local banks and of the branches of foreign banks in Bulgaria. The BNB may require any accounting and other documents, as well as any information on their activities be submitted, and may conduct on-site inspections effected by officers and other persons authorised by it. In performing its supervisory functions, the central bank and the persons authorised by it are liable for damages only if they are proved to have been caused deliberately by central bank officers or persons authorised by the central bank.

Enterprises which may be assumed to be conducting bank operations without a permit, must submit upon demand from the central bank the required information and documents. For that purpose, the authorized persons may make on-site inspections.

Government authorities and officials are expected to cooperate, within their powers, with their powers, with the banking supervisory bodies in the performance of their functions.

When conducting on-site inspections, the banking supervisory bodies have the right to: 1) free access to the premises of persons conducting bank activity; 2) demand documents and collect information pertaining to the execution of the task assigned; 3) appoint experts; 4) conduct counter-inspections in other bank and nonbank enterprises on issues related to the inspection; 5) apply to a court of law to restrain or garnish the property of persons who have inflicted damages; 6) attend the meetings of the managing and controlling bodies of banks.

The BNB may execute a revocation of the banking license if the commercial credit institution has committed infractions of the Law on Banks, has not started the permitted bank operations within 12 months after the granting of the permit, or

if the license of a foreign bank with activity in Bulgaria by means of branch has been revoked by the competent authority in the country of domicile. In such cases a forced liquidation will be initiated.

The BNB, however, is obliged to revoke the license (i.e. there is no place for discretion in such cases) if the commercial bank fails to pay its obligation due for more than seven days or if the total of bank's liabilities exceeds the total of its assets. Only the central bank may determine the value of bank's assets and liabilities. This is to be done in accordance with the supervisory requirements and rules elaborated by the BNB. The bankruptcy court is obliged to institute bankruptcy proceedings in this situation and only the central bank may petition the court to institute such proceedings. The petition of the BNB must contain only a verified copy of its act for revoking the bank's license, as well as the grounds for revoking the license. If the petition of the central bank meets these requirements, the court should announce the bank's insolvency, institute bankruptcy proceedings, appoint an assignee in bankruptcy from the list at the central bank, etc.

Apart from the revoking of bank's license (which should be considered an ultimate measure), the BNB has at its disposal many other actions or penalties with respect to a bank found guilty of a violation of the Law on Banks or legislative or other acts and prescriptions of the central bank; of a breach of fiduciary duty; of prevention of exercising banking supervision; of effecting any transactions or operation representing money laundering; etc. In such cases the BNB may impose 15 different kinds of measures, commensurate with the seriousness of the bank's misconduct. These measures vary from issuance of a written warning to the bank, through imposing more stringent prudential requirements or forcing the bank to increase its capital, to the appointment of two or more conservators for a specified period of time and the revoking of bank's license. Acts of enforcement of these measures come immediately into effect and are not subject to court appeal.

The systemic crisis of 1996–1997 stressed the significance of central bank independence and demonstrated the undesirable consequences of its undermining. The new legal framework of 1997 established strong guarantees in this respect, in its four dimensions – institutional, functional, personal and financial independence. Relating to the institutional independence, Art. 44 of the BNB Statute clearly formulated the principle of independence: “in the performance of its functions, the Bank shall be independent from any directions of the Council of Ministers and from other state bodies”. This means that the Council of Ministers and other state organs do not have the right to approve, suspend or otherwise annul or defer Balgarska Narodna Banka's decisions. On the other hand, the BNB Statute established an accountability of the Balgarska Narodna Banka to the Parliament (see Articles 1(2), 50 and 51 of the BNB Statute). This form of accountability does not entail a right of the Parliament to give instructions or approve, suspend, annul or defer decisions of the BNB.

In the context of functional independence, Art. 2 (1) LBNB in its 1997 version stated that “the main task of the Balgarska Narodna Banka shall be to contribute to the maintenance of the stability of the national currency”.

The issue of personal independence was already addressed in the initial version of the LBNB by Art. 12 (4), according to which the National Assembly should appoint the Governor for a term of six years. The BNB Statute stipulates that only persons of the highest integrity and prominent qualifications in economics, finance or banking may be elected or appointed members of the Governing Council. Either the National Assembly or the President of the Republic, as appropriate, is bound to terminate the mandate of any member of the Governing Council before the set term on explicitly and strictly defined grounds. Nevertheless, for complete harmonization it was necessary that the BNB Statute ensured that only those grounds of dismissal as listed in Article 14.2 of the ESCB Statute were admitted.

Regarding the financial independence, Art. 16 (13) LBNB included among the prerogatives of the Governing Council to approve the annual budget. The annual budget, as approved by the Governing Council, was then submitted for adoption by the National Assembly (Art. 48 (1) of the BNB Statute). The administrative expenditure was made in accordance with a decision of the Governor or of a Deputy Governor authorised by him (Art. 48 (2) of the BNB Statute).

It was incumbent upon the Governing Council to approve the annual balance sheet and the annual report (including the budget report) to be submitted together with the annual financial statement and the international auditor’s report to the National Assembly. The reports on the budget outlays of the Balgarska Narodna Banka are examined by the National Audit Chamber, which prepares a special report on the results of the examination.

The outlined juridical regime for the functioning of the BNB has been in practice since 1997, ensuring to a great extent the needed degree of independence for the proper functioning of the central bank. The LBNB in its version of 1997 received positive assessments on the part of many international partners of Bulgaria (EU, IMF, World Bank, etc.). It was perceived as a modern source of law, assuring acceptable degree of autonomy for the central bank. Nevertheless, several legal provisions had still to be revised in order to achieve complete formal compliance with the requirements of the ESCB Statute. The process of elaborating the said norms – which culminated with the amendments to the LBNB of 2005 and will be the object of the following explanations – could not be entirely understood without this background in mind. The incorporation of the external recommendations within the already existing framework is instructive for the efforts of many Central and Eastern European countries in revising their banking legislation in view of acceding the EU.

4. Constitutional Guarantees for Central Banks' Independence – on the Crossroad between Temptation for Juridical Perfection and Reality

When dealing with central bank's independence, one preliminary question springs up in mind as especially challenging: whether the autonomous status of a central bank is sufficiently protected by the provisions of an "ordinary" law – which could be modified at any moment in undesirable direction by an essentially politically motivated organ as the national Parliament? If enshrined in the Constitution (which in most countries is subject to quite cumbersome way of revising), the independence could become a far more secure "asset" of the central bank. Analyzing the Constitution of the Russian Federation, Barenboim (2001) even observes that the Central Bank of Russia is the only constitutional body, other than the courts, to which the term "independence" applied at all within the Constitution (as a matter of fact, it follows from the subsequent explanations of the author that this enviable constitutional status has not prevented the opposite situation – to have the provisions of Federal Law No. 394-FZ depriving the Bank of Russia of real independence in several important aspects).

The independence of the *Balgarska Narodna Banka* is clearly stipulated in Art. 44 LBNB. Before the revisions of 2005 this text stated: "In the performance of its functions, the Bank shall be independent from any directions of the Council of Ministers and from other state bodies."

A key issue in this context is whether the importance of a tenet like central bank's independence could not justify its "upgrading" also as a constitutional principle. At present the Constitution of the Republic of Bulgaria (CRB) allots quite a negligible attention to the BNB, mentioning it only while enumerating the competencies of the National Assembly – namely, its prerogative to "elect and dismiss the managers of the *Balgarska Narodna Banka* and other institutions, designated by law" (Art. 84, point 8 CRB). It should be noted, however, that with this particular wording the constitutional provision is somewhat ambiguous and creates certain collision with the LBNB of 1997. According to Art. 10 LBNB, on the first place among the managerial bodies of the BNB figures its Governing Council, although three of its members are not to be elected by the Parliament, but appointed by the President of the Republic. Does it mean that "managers of the BNB" according to the Constitution are only those elected by the Parliament – the Governor and the three Deputy Governors? Even if so (such interpretation seems logical), the employed constitutional terminology – "managers of the *Balgarska Narodna Banka*" – could hardly be defined as unambiguous.

In theory, there are several possible solutions for the concrete normative position and the adequate scope, through which the principle for independence of the central bank might be formulated:

1. The first approach is to retain the existing solution, the BNB's independence remaining only an object of the relevant statutory act. Such a treatment is not uncommon for the juridical frameworks of considerable number of countries – both “old” and “new” members of the EU. A negative aspect of this approach, however, is the potential possibility for the central bank independence to be encroached upon through routine changes of the statutory law, which could be executed just by means of a simple majority of one or another Parliament's composition. If enshrined in a constitutional provision, the independence principle naturally creates far more serious preventive mechanisms against its own infringement.

2. Another possible solution, already at the level of the Constitution itself, is to unambiguously declare the principle of independence, e.g. “The Balgarska Narodna Banka is the central bank of the Republic of Bulgaria and is independent in performing its activities.” The constitutional proclamation of the principle creates an obligation for observing it in the course of any subsequent change in the legal framework with regard to the central bank. This rather abstract statement of the independence principle, however, will predetermine also an active role of the institution engaged in assessing constitutionality – the Bulgarian Constitutional Court. Its will be the control over the observance of the basic principle in the context of one or another legislative solution concerning the central bank. The choice of such a strategy combines positive and negative aspects. Among the positive ones we could underline the flexibility in interpreting the independence postulate and assuring the “life” of the constitutional provision through its binding interpretation on the part of a respectable institution like the Constitutional Court. On the other hand, potential unfavorable results could stem from the intricate combination of juridical and political considerations in each interpretation on the part of the institution for constitutional adjudication, which is characteristic not only for the Bulgarian Constitutional Court and which acquires particularly significant dimensions in the case of generally formulated principles, whose interpretation requires quite specific knowledge. It is exactly in this category where falls the principle of the independence of the central bank.

3. A third solution to be put for consideration is to have a more detailed regulation of the BNB status within the frames of the Constitution itself. This would comprise not only the declaration of the independence principle, but also its elaboration by means of other constitutional provisions, related to the basic function of the central bank in the state, as well as to the four already mentioned dimensions of its independence – institutional, functional, personal and financial. Such an approach could be realized if a special chapter is devoted to the central bank (e.g. systemically situated after the present Chapter VI “Judicial Power” or after Chapter VII “Local Governance and Local Administration”), or at least a particular group of provisions (e.g. following the present Art. 19, Par. 1 – “The economy of the Republic of Bulgaria is based on the free economic initiative...”). The positive effects of such a solution are obvious – the central bank's status will

finally find more detailed treatment in the organic law of the state, restricting in this way the opportunities for eventual "inventive" interpretations both on the part of subsequent compositions of the legislature and of the Constitutional Court. It should be stressed, however, that one similar approach seems far from easy to be followed. On the first place, the very construction of the supreme law naturally represents a rather conservative system, characterized by high degree of normative generality which could not accept one such radical intervention, with the treatment of quite specific scope of problems. We should not forget that one similar solution can be considered as a risky precedent, allowing other institutions of comparable importance in the institutional mechanism of the state also to put forward pretensions for constitutional status – e.g. the Court of Auditors. It should be kept in mind that in comparative aspect the constitutional approaches with regard to the central bank are quite multifarious in different states – present or future members of the EU. As a whole, the detailed treatment of central bank's status on constitutional level is not a usual case. There are even constitutional documents of countries with durable and profound democratic traditions where the central bank is not mentioned at all – France, Germany, Italy, Spain, Greece... Where we find constitutional provisions regarding the central bank (in countries like Finland, Sweden, Lithuania, Poland, Hungary), the accent is put mainly:

- a) upon its basic functions (to formulate and implement the monetary policy, to realize its exclusive right of issuing money with the status of a legal tender);
- b) upon its structure of governance (with the prerogatives of the different bodies);
- c) upon the way of electing its management (with clarifications regarding the mandates' duration and sometimes regarding the conditions for their pre-term termination).

Almost universally in these cases the constitutional norms contain also a delegation for arranging the remaining elements of the bank's status through a special law.

In the final analysis, it should be accepted that if the national legislator wants to stress upon the special, *sui generis* position of the central bank within the system of state power – equally detached from the executive and legislative branches – its explicit constitutional treatment is highly desirable (Neumann, 1991). If, however, as in the case of Bulgaria, this approach proves unrealistic in a short to medium term, the "ordinary" statutory law provides sufficient basis for regulatory improvement in achieving adequate autonomy.

5. Formulating the Main Objectives of the BNB

Since the very beginning of the monitoring process on the part of the ECB legal team (in 2000), the LBNB faced certain criticism regarding the statement of its Art. 2, Par. 1: "The main task of the Balgarska Narodna Banka shall be to contribute to the maintenance of the stability of the national currency..." Although this declaration describes the real role – and in fact the only possible one - of the

Bulgarian central bank in the context of a strict currency board arrangement, it was underlined that such a formulation does not reflect unambiguously the primary position that should be accorded to the maintenance of **price stability** as a basic objective of any EU central bank.

The adduced arguments stressed upon the fact that the exchange rate stability represents only one element of the price stability, as envisaged in the Treaty on the establishment of the European Community. Only those countries may qualify for the adoption of the euro that have achieved stable value of money as expressed in goods (price stability in narrow sense), in foreign currencies (exchange rate stability), and in money itself (interest rate stability).

In order to fulfill the harmonization requirement, remaining at the same time in line with the real powers of the Bulgarian central bank at present (unable to develop full-scale monetary policy, apart from setting minimum reserve requirements), the Bulgarian legislator adopted the following wording of Art. 2, Par. 1 LBNB: “The primary objective of the BNB shall be to maintain price stability through ensuring the stability of the national currency and implementing monetary policy as provided by this Law.”

The accent upon price stability as a primary objective of the national bank is present in most legal acts, dealing with the status of central banks in Member States of the European Union (EU). In this sense are Art. 2 (2) of the Bank Act 1998 of the Netherlands; Art. 2 (2) of the Federal Act on the Oesterreichische Nationalbank; Art. 11 (a) of the Bank of England Act 1998; Art. 12 of the Statutes of the Banque Nationale de Belgique; Art. 1 (1) of the Greek Law No. 2548 – “Provisions relating to the Bank of Greece”; Art. 7 (2) of the Law of Autonomy of the Banco de España; Art. 3 of the German Bundesbank Act; Art. 2 (2) of the Law Concerning the Monetary Status and the Banque central du Luxembourg; Art. 2 of Act No. 214/1998 on Suomen Pankki; Art. 1 of the Statute of the Banque de France; Art. 2 of “The Sveriges Riksbank Act (1988:1385)”. As a matter of fact, the stressing upon price stability as main objective by statutory laws concerning the central bank seems to exclude the notion of “political independence” as understood by Grilli et al. (1991) and associated with the selection by the central bank itself of its policy objectives – they are pre-determined by the law.

Under the adopted revision of Art. 2, Par. 1 LBNB, the maintenance of price stability is linked with ensuring the stability of the national currency, since as a consequence of the currency board regime the central bank’s monetary policy is expressed just in preserving the exchange rate stability. Under the present arrangement – established through nothing else but the LBNB and planned to continue being into force not only until the accession of Bulgaria to the EU, but also until joining the Economic and Monetary Union (expected to happen at a later stage) – the BNB is incapable of employing the traditional instruments of a central bank for fully-fledged “maintenance of price stability”.

In the course of revising Art. 2 LBNB a necessity arose even at this relatively early stage to establish a link between the BNB functions as a national institution and its role in the context of the common policy pursued by the EU. It is underlined that the BNB will support the general economic policies of the European Community with a view to contributing to the achievement of the objectives of the Community as laid down in Art. 2 of the Treaty establishing the European Community. The latest version of the LBNB underlines that the central bank will act in accordance with the principle of the open market economy with free competition, favoring an efficient allocation of resources and will follow the principles laid down in Art. 4 of the Treaty. This formulation coincides with Art. 2 of the ESCB Statute. This text identically enumerates the objectives of the ESCB. It is natural to have this formula reproduced in a comparable way (or to have an explicit reference to it) in the statutory acts of the central banks composing the ESCB. Similar is the wording of Art. 2 (2) of the Federal Act on the Oesterreichische Nationalbank; Art. 12 of the Statutes of the Banque Nationale de Belgique; Art. 3 of the German Bundesbank Act; Art. 1 (2) of the Greek Law No. 2548 – “Provisions relating to the Bank of Greece”; Art. 7 (2–3) of the Law of Autonomy of the Banco de España; Art. 41 of the Statute of the Banca d’Italia; Art. 2 of the Law Concerning the Monetary Status and the Banque central du Luxembourg; Art. 1–3 of Act No. 214/1998 on Suomen Pankki; чл. 1 of the Statute of the Banque de France.

Of course, the introduction of such a text in the LBNB imposes the need to have its actual entering into force moved forward in time, up to the moment of accepting Bulgaria in the EU. This is possible as a legal technique, moreover having in mind that a similar approach has been chosen for instance by the Greek legislator, which stipulates in Art. 1 (2) of Law N 2548; “As from the adoption of the single European currency (euro) as the national currency of Greece, the National Bank of Greece, as an integral part of the European System of Central Banks and in accordance with the terms set out in Article 105, Par. 1 of the Treaty on European Union, shall pursue the primary objective of maintaining price stability.” Much in the same way the norm of the LBNB provides that it would be applied “...from the date of accession of the Republic of Bulgaria to the European Union...”. Thus the new Paragraph 2 of Art. 2 LBNB has now the following wording:

“(2) The Balgarska Narodna Banka shall act in accordance with the principle of the open market economy with free competition, favoring an efficient allocation of resources. From the date of accession of the Republic of Bulgaria to the European Union and without prejudice to the primary objective of price stability, the Balgarska Narodna Banka shall support the general economic policies in the European Community with a view to contributing to the achievement of the objectives of the European Community as laid down in Art. 2 of the Treaty establishing the European Community.”

The above formulation is almost identical with the text of Art. 2 (2) of the Banking Law of the Netherlands (1998). This legal act traditionally is highly esteemed as reflecting with maximal precision the requirements of the ESCB Statute within a national juridical framework. That is why the Dutch law is usually pointed out as a model for the accession countries in their efforts to adapt central bank statutes.

A very important feature of the structuring of Art. 2 LBNB is the prioritization of central bank's goals. Following the insistence of some members of the Parliament, the Law explicitly stipulated that the BNB shall support the policy of sustainable and non-inflationary growth. There are researchers who believe that in formulating and implementing monetary policy any central bank should pursue "its twin goals of promoting domestic price stability while stimulating real growth". As Cecchetti (1999) explains, these goals remain at the core of any central bank's policy in a representative democracy. Nevertheless, the Bulgarian legislator clearly prioritized the objectives of the BNB, underlying in the third paragraph of Art. 2 LBNB that the support of policy of sustainable and non-inflationary growth must be without prejudice to the objectives under Paragraph 1 (maintenance of price stability as a primary objective) and Paragraph 2 (acting in accordance with the principle of the open market economy with free competition, favoring an efficient allocation of resources) of the same article. It is to be believed that this prioritization reflects a clear policy choice in favor of the price stability, even if sometimes at the expense of the "sustainable growth", which should in addition be always "non-inflationary" in order to benefit from the support of the central bank.

The formulation of the central bank's main objective is directly related with the issues regarding its autonomy. The central bank should be independent not because some theory declared that as the optimal way for its existence, but because abundant empirical studies (MAE Operational Paper, 1998; Webb and Neyapti, 1992; Guitian, 1996) have convincingly demonstrated that this particular main objective of price stability is best achieved by an independent central bank. Miller (1998) has elaborated a fascinating "interest-group theory of central banks' independence", whereupon with an independent central bank in place, politicians provide assurance that they will not induce an inflationary burst that unravels deals previously negotiated with the interest groups. With these groups politicians conclude an *ex ante* deal for support in exchange of preserved expectations regarding all social contracts based on the assumption of predictable inflation. Gabilondo (2005) rightly adds an important caveat to this theory, considering as mandatory precondition for its application the entrenchment of a private creditor class capable of pressing demands on government officials. Without the existence of private rent-seeking economy it would be completely futile to recommend government action to increase formal independence of the central bank (as the case of the established in 1997 Banco Central de Cuba convincingly demonstrates).

Whether or not we accept the “interest-group theory” as a real incentive for creating independent central banks or just as an intriguing intellectual exercise, we can completely sign the conclusion of Miller that the institution of the independent central bank becomes attractive as a means whereby the government can “tie its hands” by giving control over price levels to an institution without the same perverse incentives for *ex post* monetary expansion; institution which is insulated from political forces and which has conservative (that is, anti-inflationary) attitude towards monetary policy.

6. Creation of Additional Safeguards for the Independence of the Central Bank

6.1 Institutional and Functional Independence

With the purpose to additionally accentuate upon the functional independence of the BNB, the national legislator adopted a new construction of the key Art. 44 LBNB:

“Art. 44. When exercising their powers and carrying out their duties under this Law, the Balgarska Narodna Banka , the Governor and the members of the Governing Council shall be independent and neither the Bank, nor the Governor, nor the members of the Governing Council shall seek or take any instructions from the Council of Ministers or from any other bodies and institutions. The Council of Ministers and other bodies and institutions shall not give instructions to the Balgarska Narodna Banka , the Governor or the members of the Governing Council.”

This wording precisely reflects the content of Art. 7 of the ESCB Statute, dealing with the independence of the national central banks participating in the ESCB. In comparison with the previous version, enlarged is the scope of those “other bodies and institutions” which cannot exert influence over the decision-making process of the BNB. Not only national (both state and municipal), but also international and supra-national institutions are already included among them.

The prohibition for monetary financing on the part of the central bank is usually considered as an essential element of its functional independence. One of the key rules of the LBNB in its 1997 “currency board version” was Article 45. This provision was considered as a consequence of one of the most dramatic events in the development of the 1996 systemic crisis, when the Parliament forced the BNB to extend a direct credit to the government totaling over 6% of GDP to meet all its financial needs pushed to the end of the fiscal year. According to Balyozov (1999), this step finally monetized the cash deficit in the budget and practically pushed the country to hyperinflation. Under the then existing Law on the BNB, the only available defense of the central bank seemed to be a desperate letter that the BNB sent to the Chairman of the National Assembly Budget Commission expressing the

central bank's disapproval in principle with the inflationary mode of budget deficit financing.

According to Art. 45 LBNB in its initial version, the central bank might not extend credits in any form whatsoever to the State or to any state agency. The only exception covered credits against purchases of special drawing rights from the International Monetary Fund. Indeed, Article 3 (5) of the Law on the State Budget Procedures stated that "the Balgarska Narodna Banka may extend credits to the state budget under the terms and according to a procedure established by the Law on the Balgarska Narodna Banka" (this very procedure is contained in Article 45 LBNB). This exception, however, has ever been construed in a restrictive manner, as the law stipulated exceptionally strict conditions for extending such credits – the decision of the Managing Board of the Balgarska Narodna Banka should be taken no later than seven days after the date of the relevant purchase of special drawing rights, the State must utilise the credit within 90 days after the date of the relevant purchase (if not, the right on the unutilised part of the credit shall be extinguished), a complete synchronisation must be achieved between the payments of principal and interest on the part of the State and the date whereon the Balgarska Narodna Banka must effect the relevant payments to the IMF.

After the revisions executed in 2005, the prohibition of Art. 45 LBNB is more encompassing. The norm already stipulates that the BNB may not extend credits in any form whatsoever, including through purchase of debt instruments, to the Council of Ministers, municipalities, as well as to other government and municipal institutions, organizations and enterprises. The only exception are the credits to the government against purchases of Special Drawing Rights from the International Monetary Fund (Art. 45, Par. 3). According to the opinion of the European Commission, this exception – while closely connected with the currency board system – provides opportunity for the central bank to extend credits to government which are not exclusively in the context of respective government's obligations towards the IMF and consequently suspect to represent a form of monetary financing. Due to this reason, it was decided and proclaimed in a special final provision of the revised law that the exception will cease to exist from the date of the real accession of Bulgaria to the EU, without releasing the state from the obligation to effect all remaining principal and interest payments due to the central bank no later than the dates whereon the BNB is to effect the relevant payments to the IMF and up to amounts required for these payments.

As regards the prohibition of privileged access of public authorities to financial institutions, another important dimension of the currency board arrangement in fact contributes to achieving this goal. Indeed, under the general principle enshrined through Art. 33 LBNB, the Balgarska Narodna Banka may not extend credits to banks (private as well as public banks), whatever their financial situation. There is an exception to this rule, according to which, upon emergence of a liquidity risk that may affect the stability of the banking system, the Balgarska Narodna Banka

may extend to a solvent bank lev-denominated credits with a maximal maturity of 3 months, provided they are fully collateralised by gold, foreign currency or other such high-liquid assets. The terms and procedure for extension of such credits, as well as the criteria establishing the occurrence of liquidity risk, are determined in details by Regulation No. 6 of the Balgarska Narodna Banka on Extending Collateralised Lev Loans to Banks (March 1998). That was the way of inducing commercial banks to take only market principles into consideration when extending credit to the public sector.

Nevertheless, a problematic rule still existed – Art. 9 LBNB, which provided that where the BNB's balance sheet indicates that the amount of its assets is less than the amount of its liabilities and the statutory fund, the Minister of Finance should concede the BNB negotiable, interest-bearing securities issued by the Council of Ministers to the amount necessary to cover the deficit. The securities conceded were to be redeemed from the annual excess of the BNB's revenue over expenditure prior to deduction of the amount for the reserve fund. It is clear that such a provision – albeit quite unusual for the established orthodoxy in drafting central banks laws – is vital for filling an inevitable gap associated with the severe currency board mechanism: in the unusual case when the hypothesis of Art. 9 actually happens, the central bank merely does not possess any other source for filling the gap, since it has no recourse to the traditional behavior that any “classic” central bank would adopt in this situation – namely, to issue money whose exclusive issuer it is by the law.

However, according to the views expressed by the assessment teams of certain European institutions, the provision of negotiable securities to the BNB on the part of the Minister of Finance (who according to the Law on the State Debt meanwhile had become the sole body empowered to issue government securities) and the requirement for subsequent reimbursement of these securities to the Treasury could be regarded as a mechanism that might be used for extending a cleverly dissimulated credit on the part of the central bank to the government in the sense of Art. 101 of the Treaty Establishing the European Community. Since it was imperative to avoid any possible interpretation of Art. 9 LBNB as a hidden mechanism for crediting the government, several changes were introduced in the new version of the Law.

The requirement for conceding government securities is now repealed. The Law stipulates only that the Minister of Finance must replenish the statutory fund of the BNB to the amount necessary to cover the deficit, without specifying the type of contribution – money or securities. In this way a greater flexibility is provided for the Ministry of Finance to take into consideration the particular features upon the occurrence of the exceptionally extraordinary situation under Art. 9 LBNB. It should be borne in mind that the Law on the BNB imposes very conservative principles for the management of the international reserves of the central bank, which renders as purely theoretical the possibility of realizing losses triggering the

mechanism described in Art. 9. In addition, the adopted change did not modify the existing norm of Art. 9, Par. 2 LBNB, which stipulates that the regime under Art. 9, Par. 1 can be applied only in exceptional cases, when the resources of the Reserve Fund and on the BNB's Special Reserve Account under Art. 36, Par. 1 have been exhausted.

The present version of the Law envisages that the Minister of Finance will replenish the statutory fund of the BNB to the amount of the deficit. The rule is connected to the role of the BNB as the central bank of the country, which requires in the event of a loss exceeding the amount of the statutory fund and the reserves the intervention of the State represented by the Minister of Finance for assuring the resources necessary to replenish the gap.

6.2 Financial Independence

Another recommendation of the European institutions that had to be faced in the course of the LBNB revision concerned the adoption of the budget of the central bank. It was rightly pointed out by the observers of the ECB that the initial concept of the law, providing in Art. 48, Par. 1 that the expenditure of the Balgarska Narodna Banka shall be made in accordance with the annual budget *adopted by the National Assembly*, contains the potential to substantially encroach on the autonomy of the BNB. A change was needed, allowing the central bank to receive independent access to sufficient financial means, permitting it to fulfil its mandate and be conducive to the achievement of the common objectives upon joining the ESCB. It was not justified for a third person – neither the government, nor the Parliament – to be in a position to determine the budget of the central bank or the allocation of profits. Only a subsequent check of the financial reports of the BNB was recommended, and that solely to an extent not undermining its independence. Norms with similar meaning were already existent in the LBNB – Art. 50 and 51. It is incumbent upon the Governing Council to approve the annual balance sheet and the annual report (including the budget report) to be submitted together with the annual financial statement and the international auditor's report to the National Assembly. The reports on the budget outlays of the Balgarska Narodna Banka are examined by the National Audit Chamber, which prepares a special report on the results of the examination.

As an additional drawback of the solution to have the central bank's annual budget adopted in advance by the Parliament was considered also the lack of special arrangements, treating the case when the budget, already approved by the Bank's Governing Council, does not gather the necessary support in the National Assembly.

The comparative analysis of legal acts concerning EU central banks demonstrates that in these laws the budget issue is treated most frequently in the sense to have it included among the competencies of the bodies of the central bank

itself. Thus according to Art. 19 (2) of the Articles of Association of De Nederlandsche Bank, its Governing Board compiles a budget of the Bank's expenditure before January 1 of the year to which the budget relates, while this budget requires the prior consent of the Supervisory Board. Under Art. 54 of the Statute of the Banca d'Italia expenditure comprises the amounts spent on ordinary administration, replenishing the gold reserve and the issue of banknotes and the like, taxes and other charges prescribed by law and amounts disbursed for purposes of charity or for contributions to works of public interest within the limits established annually by the Board of Directors. The General Council of the Banque de France decides on the allocation of the Bank's own funds, draws up the Bank's expenditure estimates and amendments, makes up the Bank's balance sheet and accounts, and proposes the appropriation of net profit and the dividend to be paid to the State (Art. 11 of the Statute of the Banque de France). A decree of the Conseil d'Etat lays down the procedures for drawing up the Bank's annual budget. Among the powers of the Parliamentary Supervisory Council of Suomen Pankki exists the prerogative to "decide, upon proposal of the Board, on measures concerning the Bank's profit or loss for the financial year". According to Chapter 10, Art. 2 of "The Sveriges Riksbank Act (1988:1385)" each year prior to the end of December the Executive Board drafts a budget for the Riksbank's administrative activities during the following accounting year. Then the Executive Board submits the budget to the Parliamentary Standing Committee on Finance, the Office of the Parliamentary Auditors and the Governing Council for their attention. Art. 29 of the Law of 23 December 1998 Concerning the Monetary Status and the Banque Central du Luxembourg stipulates that no later than the end of each financial year the Board of Directors submits to the Council for approval the income and expenditure budget for the forthcoming year. An integral part of it is a report by the staff representatives, the organization chart including tables showing the number of all current and planned staff, as well as guidelines on certain remuneration supplements.

The implementation of schemes as discussed above relating to budget adoption (with its typical sanctioning on the part of at least two different management bodies) was not applicable to the BNB due to the typical for it over-simplified system of governance – with a sole collective management body: the Governing Council.

Somewhat contradicting to the described independence relating to budget adoption seems the practice existing in Spain and Portugal. According to Art. 4 (2) of the Law of Autonomy of the Banco de España: "the Bank's draft budget for operating expenses and investments, once approved by its Governing Council... shall be forwarded to the government, which will submit it to Parliament for approval." Art. 52 of the Organic Law on Banco de Portugal proclaims that "1. An operating budget shall be drawn up every year. 2. The annual budget shall be forwarded to the Finance Minister not later than November 30 of the preceding

year.” It could be observed that despite the membership of Spain and Portugal in the ESCB, the cited legal provisions appear to be in even greater contradiction with the independence requirement as per the ESCB Statute than Art. 48, Par. 1 LBNB, since a role of the government, the parliament or only of the Minister of Finance (if in the latter case this role is not restricted solely to the execution of the budget) is envisaged in the process of budget adoption.

The explanation for the lack of treatment relating to the budget issue in the central bank’s legislation of certain EU Member States should be found in the fact that several banks are incorporated as independent joint stock companies. In this case the question for defining a “budget” on the part of some body external to the central bank is virtually non-existent. As a matter of fact, in an historical aspect we could discover even attempts for normative reorganization of the Balgarska Narodna Banka as a privileged shareholding bank (through the BNB Statute, adopted by the National Assembly and promulgated by Decree No. 100 of February 11, 1883, but never applied). However, at the moment it was not realistic to think about such a solution – the LBNB is drafted in close cooperation with the International Monetary Fund and the World Bank, it functions properly and nobody questions its statutory arrangement. Nevertheless, one should admit that even at present the BNB is a “*sui generis*” legal entity – a body corporate with a unique position within the structure of State governance. The central bank is not a “governmental institution” in the proper sense; but it is neither an ordinary commercial company. If we pose the question who is the owner of the BNB’s basic capital (called “statutory fund” by the LBNB), we should accept that the owner is no one else but the BNB itself, since in its statutory act there is no provision similar, for instance, to Art. 6 of the Statute of the Banque de France (“The Banque de France is an institution whose capital is owned by the State.”), or to Art. 2 of the German Bundesbank Act (“...its capital, amounting to five billion Deutsche Mark, is held by the Federal Government.”).

The drafting team, working on the revision of the LBNB, has obviously faced the need to liberate an important element of the central bank functioning from the influence of a politically motivated body as the Parliament. That is why several possible solutions were evidently considered.

A/ According to the first variant, it could have been possible to bind the annual budget with some objective criterion, a strictly fixed numerical factor, that will not be dependent on the will of a particular body, but only on an explicit legal provision. Theoretically, such a factor could be the statutory fund of the BNB – 20,000,000 leva under the present version of the LBNB. If juxtaposed, the annual budgets of the BNB for the period 1997–2001 did not exceed the statutory fund more than three to four times. A provision with the following content could have been considered: “*The annual expenses of the BNB cannot exceed... times its statutory fund.*” It was possible also to additionally broaden the basis with the inclusion in it of the Reserve Fund (according to Art. 8, Par. 2 LBNB) - “*The*

annual expenses of the BNB cannot exceed... times its statutory fund plus the Reserve Fund". There were several drawbacks stemming from such an approach – it was not usual for the existing legislative practice; it could not boast of quite an appealing wording; it lacked the needed flexibility in case when a necessity emerged for more substantial investment expenses on the part of the BNB during a particular period.

B/ The second variant initially seemed quite radical – to empower the Governing Council of the BNB with the adoption of its annual budget. Since the National Assembly is by definition a politically driven institution, the Bulgarian legislator faced the somewhat paradoxical need to release from its own discretion one so important element for the proper functioning of the central bank as its budget.

That is why the adoption of the annual budget of the BNB was inserted among the prerogatives of its Governing Council. On the part of the drafting team this should have been a brave, but well motivated strategy. It was completely dependent on the authority and respect, already acquired by the central bank: should any doubts in this sense existed among the Parliament members, the autonomy in budget adoption would not gather the necessary approval in the plenary hall. However, the proposed decision had the advantage of organically combining the present organizational model of the Bulgarian central bank with the unambiguous requirements of the ESCB Statute and the analytical reports of EU institutions.

By the way, such an approach was not unfamiliar from the legal history of Bulgaria. It was just the Managing Board of the Bank that approved the annual budget of the BNB after 1928. According to Art. 49 of the then Law on the Balgarska Narodna Banka (version published in "State Gazette", N 189 of November 20, 1926): "The expenses of the Bank are to be made by the order of its Managing Board, in accordance with the annual budget that the Governor has presented for approval to the Managing Board." The context of adopting this solution in 1926 is quite instructive, since until then the budget had to be approved by a member of the executive (the Minister of Finance according to the laws of 1906 and 1924). The reform with the LBNB of 1926 aimed at nothing else but strengthening the independence of the central bank and again was imposed under external pressure – being based on the recommendations of the Financial Committee of the League of Nations in relation to the negotiation of the so-called "Refugee Loan" of 1926.

Clear indication for the need to follow this particular direction for legal reform were the changes adopted in 2002 in Law N 9/1993 of December 17, 1992 on Česká národní banka (amendments introduced with the obvious purpose of meeting all requirements associated with the future membership of the Czech Republic in the EU). According to Art. 5, Par. 2, point "b" of the law in its latest version, as an explicit prerogative of the Banking Board (the highest management body of the central bank) is stipulated "to approve the budget of Česká národní banka".

6.3 Personal Independence

Another cluster of problems that the revision of the LBNB had to address was connected with the mandate of the members of the BNB Governing Council. Several changes were proposed for restricting the reasons leading to premature termination of their prerogatives.

Upon comparing the regime adopted by the LBNB with Art. 14.2 of The ESCB Statute, legal specialists of the EU institutions formulated two mutually related recommendations. The first one concerned the inclusion in the Bulgarian law of only those grounds for dismissal that appear in Art. 14.2 of the ESCB Statute. The second advice was to provide an opportunity for judicial appeal of the decision for dismissal. It is instructive to analyze what were the opportunities for realizing these two recommendations and how the Bulgarian legislator faced the challenge.

A/ According to Art. 14.2 ESCB Statute “A Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct...”

With a view of adopting the requirement for restricting the grounds for dismissal, it was imperative to revise the initial construction of Art. 14 LBNB, which contained in its first paragraph five different hypotheses mandatory leading to dismissal, while the next paragraph envisaged four more such grounds, whereupon the elective body possessed the discretion to relieve from office the relevant member or not. Thus, according to Art. 14, Par. 1 LBNB (preceding the reform), the competent authority was bound to terminate the mandate before the set term on the ground of resignation, practical inability to perform the assigned functions for more than six months, enforcement of an imprisonment sentence for a premeditated crime, adjudication in bankruptcy in a capacity of a sole proprietor or general partner in a commercial company or cooperative which has been dissolved by bankruptcy. In contrast, under Art. 14, Par. 2 the competent authority *might*, but was not obliged to terminate the mandate of a member of the Governing Council before term's expiration, if the member in question had been involved in certain activities prohibited to him (through Art. 12, Par. 5 & 6 LBNB), if he had not attended without due grounds three or more consecutive sessions of the Governing Council, if he was guilty of serious misconduct in office, if by action or inaction he had caused a failure to fulfil any task of the BNB as provided by the law. Whether to terminate the mandate under these circumstances or not depended exclusively on the concrete assessment of the electing institution – should it be the National Assembly or the President.

According to Art. 14.2 ESCB Statute, “a Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct...” The difference in the approaches embraced by the ESCB Statute and the LBNB could be discovered immediately. Under the Statute, enforced guarantees are provided solely for the Governor of a

national central bank. On the contrary, the Bulgarian Law treats in a completely identical way all the members of the Governing Council regarding the question of their premature dismissal. This should not be considered a drawback in the light of the EU legislation. To have in place identical guarantees for non-infringement of the mandate of all members of the central bank management body is helpful for the independence of the central bank. If this idea is not followed in the ESCB Statute, this is perhaps due to the fact that many European central banks have a rather complicated and multi-layered management structure. For example, the Banque Nationale de Belgique possesses four organs – Governor, Board of Governors, Council of Regency and Board of Censors. Comparable is the composition of the Banco de Portugal – its organs include the Governor, the Board of Directors, the Board of Auditors and the Advisory Board. The management of Deutsche Bundesbank comprises the Central Bank Council, the Directorate and the Executive Boards of the Land Central Banks. The Oesterreichische Nationalbank has a General Meeting of shareholders, a General Council and a Governing Board. In the Bank of Greece the responsibility is shared among the General Meeting of shareholders, the General Council, the Governor and the Deputy Governors, as well as the Monetary Policy Council. The management of the National Bank of Denmark is committed to a Board of Directors, a Committee of Directors and a Board of Governors. The bodies of the Banco de España are the Governor, the Deputy Governor, the Governing Council and the Executive Commission. The powers the Banca d'Italia are vested in the General Meeting of Shareholders, the Board of Directors and the Committee of the Board of Directors, as well as the Directorate, which is composed of the Governor, the Director General and two Deputy Directors General. The Council and the Board of Directors are the bodies of the Banque central du Luxembourg. Suomen Pankki also has two government bodies – the Parliamentary Supervisory Council and the Board. In the organizational structure of the Banque de France we find a Monetary Policy Council, a General Council, a Governor and Deputy Governors. The Dutch central bank comprises the Governing Board (consisting of a President and between 3 and 5 Executive Directors), the Supervisory Board and the Bank Council. The management of the Swedish Riksbank is in the hands of the Governing Council and the Executive Board. More extensive review of central bank institutional arrangements, not restricted exclusively to the EU context, could be found in Lybek and Morris (2004).

A system of governance, comparable to the Bulgarian one, exists in the Bank of England (Court of directors of the Bank, consisting of a Governor, 2 Deputy Governors and 16 directors of the Bank). Important functions are delegated to a sub-committee, composed only of the directors of the Bank.

With a view of adopting the requirement for restricting the grounds for dismissal, it was imperative to revise the initial construction of Art. 14 LBNB, which contained in its first paragraph five different hypotheses mandatory leading

to dismissal, while the next paragraph envisaged four more such grounds, whereupon the elective body possessed the discretion to relieve from office the relevant member or not. In fact, only the existence of the second way of action was justified, since it presupposes undertaking the responsibility for each and any particular decision on the part of a supreme institution of state governance as the Parliament or the President. The lack of the previous grounds under Art. 14, Par. 1, points 3–5 (imprisonment and adjudication in bankruptcy) is now treated as a condition for the very fulfillment of duties by a member of the Governing Council. This was reflected in the new version of Art. 11, Par. 4 of the LBNB:

“Member of the Governing Council shall not be a person:

1. sentenced to imprisonment for a premeditated crime;
2. adjudicated in bankruptcy in a capacity as a sole proprietor or general partner in a commercial company;
3. who has been a member of a managing or supervisory body of a company or cooperative in the last two years prior to adjudicating the said company or cooperative in insolvency.”

It is possible to observe in what direction has been changed the wording of the previously existing ground for mandate termination in the repealed Art. 14, Par. 1, point 5 LBNB: “...adjudication in bankruptcy in a capacity of a sole proprietor or general partner in a commercial company or cooperative which has been dissolved by bankruptcy”. This text was capable of leading to a situation when a Governing Council member should be dismissed because he or she had occupied such position in a commercial company or cooperative for instance 10 years before his/her election as a member of the BNB’s collective management body and 15 years before the company in question was declared insolvent. Quite obviously, in this case the insolvency could not in any way be triggered by the activities of the relevant member. Nevertheless, the previous rule of Art. 14, Par. 1, point 5 LBNB required for the mandate to be terminated, even without providing any right of the elective body to assess the concrete situation. In order to avoid this incongruity, the new version cited above binds the membership in a managing or supervisory body of a company or cooperative with a reasonable term (2 years), counted back with regard to the date of adjudicating the said company or cooperative in insolvency. Similar solution could be found in Art. 234, Par. 2, point 1 of the Bulgarian Commercial Code (where the membership in the managing body of a joint stock company is prohibited for persons that during the last 2 years preceding an insolvency have been members of a managing or supervisory body of a company affected dissolved for this reason), as well as in the Bulgarian Law on Banks (preventing from membership in the managing board or the board of directors anybody, who has participated in the management or control of a commercial bank for the last 5 years preceding its declaration in bankruptcy).

Another two reasons for dismissal, envisaged by what was formerly Art. 14, Par. 1, points 1–2 (filing a resignation and practical inability to perform the

required functions for more than six months), seemed irrelevant at all in the particular context. Both Art. 14 LBNB and Art. 14.2 ESCB Statute are obviously keen to restrict solely the grounds for unilateral dismissal on the part of the elective body, and not the mandate termination following the member's own will (resignation), or the occurrence of certain objective circumstances (practical inability to perform the required functions for a substantial period).

Brought in compliance with the sense of Art. 14.2 ESCB Statute, at present Art. 14 LBNB states the following: "The competent authority... may relieve from office a member of the Governing Council only if he no longer fulfils the conditions required for the performance of his duties under Art. 11, Par. 4, if he is in practical inability to perform his duties for more than six months, or if he has been guilty of serious misconduct."

As seen from the new text, the only grounds for premature termination of the mandate remain non-compliance with the conditions for fulfillment of duties and serious misconduct. However, if the first hypothesis is defined in a relatively clear way (the conditions for performing the duties of a member of the Governing Council are enumerated in Art. 11, Par. 4), the second one seems rather loosely formulated. The one side of the problem is finding the most relevant translation in Bulgarian or in the languages of other "new Member States" of the authentic term used in the ESCB Statute – "serious misconduct". The question remains: what is the exact content of this "serious misconduct"? Is it equal to infringement of the laws and other legal acts? To breach of the specific professional duties? To non-compliance with the work discipline? To contradiction with morals and ethics? With all the due respect to the ESCB Statute, it should be recognized that its approach in this particular case does not seem unambiguous enough. Two cumulative explanations for this are available – that the idea had been to provide for greater flexibility in the assessment of the elective body, as well as that the more general wording is balanced through the possibility for seizing the court regarding the decision for dismissal before the set term.

Nevertheless, the new version of the Bulgarian law reduces to a maximal extent the grounds for premature termination of the mandate of a Governing Council member, while the existence of these reasons (incompatibility under Art. 11, Par. 4) is submitted to strictly objective determination. This issue is closely connected to the possibility for judicial appeal of the decision for premature termination of the mandate.

B/ The already discussed hypothesis for involving the issues concerning the BNB in the context of eventual amendments to the Bulgarian Constitution provides also the opportunity to put forward one more specific problem, indirectly connected with the problem of central bank's independence in the context of joining the Economic and Monetary Union. If, however, we could discuss at length whether the BNB independence should at all be envisaged on constitutional level,

or its framework within the special law is sufficient, the issue to be discussed merely requires to be thought of in constitutional context.

This issue is connected with the explicit requirement of the ECB in its annual assessment of the financial legislation of accession countries that the national law should provide the opportunity for judicial review of the decision for pre-term dismissal of members of management bodies of the national central bank, engaged with tasks connected with the ESCB. Formulated in this way, the requirement for judicial review constitutes in fact a latitudinarian interpretation of the ESCB Statute, which is made part of the Treaty establishing the European Community through a special protocol. Art. 14.2 of the Statute envisages the right of the governor of a national central bank (constituting part of the ESCB), who is relieved from office before the expiration of his mandate, to seek judicial protection if he considers that his rights have been infringed. Art. 14.2 of the Statute is explicit, however, on the judicial body that could be seized by the Governor. The question is about the “Court of Justice” – one of the institutions of the EU. Moreover, the latter could be seized not in the case of any decision for dismissal, but solely on grounds of infringement of the Treaty or of any rule of law relating to its application.

Two conclusions stem from this construction.

- a) First, it is not possible at present for the Bulgarian law to reproduce the content of Art. 14.2, sentence two of the ESCB Statute and to provide that if the BNB Governor is dismissed before the end of his mandate, he could appeal before the Court of Justice of the European Communities. Before Bulgaria becomes a full member of the EU, the Court of Justice does not possess and could not possess any jurisdiction over the country. It is not possible through a national law of a particular state – moreover still outside the institutional structure of the EU – to assign prerogatives to a supra-national institution for adjudication as the Court of Justice of the European Communities.
- b) Second, even if Bulgaria were already a Member State of the European Union, it would hardly be necessary to reproduce the provision for appeal before “the Court of Justice” in the national law. As already mentioned, the right of the Governor of a national central bank to attack his pre-term dismissal before the Court of Justice is envisaged by Art. 14.2 of the ESCB Statute. The provisions of the Statute constitute an integral part of the Treaty establishing the European Community. This Treaty becomes part of the internal legal order of each country that is a member of or accedes to the EU. From the moment when the Republic of Bulgaria joins the European Union, all the provisions of the Treaty will acquire direct effect for the country – including the provision of Art. 14.2, sent. 2 of the ESCB Statute. This norm will become an entirely sufficient legal basis for appeal before the Court of Justice in Luxembourg. Probably from systemic point of view the rule then could be reproduced also in the Law on the BNB, but such an approach is not mandatory. In support of this view we could

adduce the fact that in the statutory acts on central banks of EU Member States explicit provisions for judicial appeal could be found quite rarely.

One example for such a norm is the new version of Art. 6, Par. 13 of Law N 6/1993 of December 17, 1992 on Česká národní banka (the revision dates from the end of 2002 and is executed with the obvious intention to meet all the requirements connected with the expected accession of the Czech Republic to the EU). According to this text, the Governor shall be relieved from office by the President of the Republic if he already does not meet the conditions for exercising his duties or if he is guilty of serious misconduct. The President of the Republic might relieve the Governor from office also if he is incapable to fulfil his duties for a term longer than six months. This decision could be referred to the Court of Justice by the Governor concerned or by the Governing Council of the ECB on grounds of infringement of the Treaty establishing the European Community or of any rule of law relating to its application.

Another similar example is provided by the provision of Art. 16 (2) of Law N 214/1998 on Suomen Pankki: "Any member of the Board, apart from the Chairman of the Board, can appeal the decision for pre-term dismissal before the Supreme Administrative Court, as provided in the relevant norms of the Law on the Application of the Administrative Law (586/1996). The ESCB Statute provides for the right of appeal of the Chairman of the Board." As could be seen from this provision, the accent is upon ensuring the right of judicial protection against pre-term dismissal of other members of the Bank's executive body, save the Chairman, since his right of appeal stems directly from the ESCB Statute, to which the national legal act refers.

That is why the recommendation of the EU institutions should be interpreted in the direction of guaranteeing the possibility for judicial appeal of the decision for premature termination of the mandate also of all the other members of the central bank's managing body, and not only of the Governor. The introduction of the right of judicial appeal before a national court would be justified also by the fact that during the period preceding the accession of Bulgaria to the EU the Governor will not be capable of using the opportunity provided by Art. 14.2 of the ESCB Statute for direct appeal before the Court of Justice of the European Communities.

The introduction of judicial control over the decision for premature termination of the mandate of a member of the BNB Governing Council proved to be, however, the recommendation most difficult to fulfil under the actual state of the Bulgarian Constitution and the separation of powers envisaged by it. At present, four amongst the members of the BNB Governing Council are elected (and eventually dismissed) by the National Assembly, while the remaining three are appointed and respectively relieved from office by the President of the Republic. An especially serious question seems to be is it admissible at all to have a judicial appeal of acts, through which the Parliament and the President exercise the above prerogatives.

It should be underlined that the possibilities for a positive answer to the above question under the present version of the Constitution are rather slight.

In theory, two solutions could be considered – to give the judicial control over acts for premature dismissal either to the Bulgarian Supreme Administrative Court (SAC), or to the Constitutional Court.

According to the Constitution of the Republic of Bulgaria (Art. 125, Par. 2) and the Law on the Supreme Administrative Court (Art. 5, point 1 *in fine*), those acts that could be appealed before the SAC include decisions of the Council of Ministers and the individual ministers, “as well as other acts, envisaged by law”. A question arises whether among these acts “envisaged by law” (in the present case the LBNB) could fall also decisions for relieving a member of the BNB Governing Council, adopted by the National Assembly or by the President. If we are more inclined to give a negative response to this question, it is due to the very nature of the administrative adjudication, being concentrated upon the control over the Executive. Neither the Parliament, nor the President is part of the executive branch. One additional argument is also the complete absence of precedent in this respect in the existing Bulgarian legislation. We could adduce managerial positions, where the requirements for independence are comparable with those relating the managers of the central bank – e.g. the management of the Court of Auditors. Nevertheless, there is no possibility for judicial appeal against decisions by means of which the elective body relieves the members of the Court of Auditors from office.

The second hypothesis also seemed impossible until recently. The Bulgarian Constitution has opted to explicitly enumerate the prerogatives of the Constitutional Court in itself. Among these prerogatives we cannot find the possibility for appealing decisions related to the election or dismissal of the central bank management. Moreover, Art. 149, Par. 2 of the Constitution explicitly prohibits the assignment *through a law* of additional powers to the Constitutional Court. Another serious obstacle is the lack of possibility for claim on the part of an individual before the institution for constitutional control (the Constitutional Court could be seized only by certain number of parliamentarians, the Council of Ministers and some highest magistrates). Consequently, appeal before the Constitutional Court could be envisaged only through an amendment to the Constitution.

Such amendment might theoretically be drafted in two ways.

- a) According to the first alternative, there will be two revisions in Chapter VIII – “Constitutional Court”. Apart from adjudicating on legality of election of Parliament members, the Court could pronounce its binding opinion on the legality of premature termination of the mandate of a manager of the Balgarska Narodna Banka. This power will be developed through enlarging the list of subjects that could seize the Constitutional Court. Thus the initiative for constitutional procedure may stem not only from one fifth of Parliament members, the President, the Council of Ministers, the Supreme Court of

Cassation, the Supreme Administrative Court and the Attorney General, but also – with respect to the legality of pre-term dismissal of a manager of the BNB – from the respective manager.

- b) Under the second option, instead of amending the chapter on the Constitutional Court, it would be possible to further develop the only text in the present version of the Constitution related to the central bank. Thus point 8 in Art. 84 (enumerating the powers of the Parliament), in parallel with the prerogative of the National Assembly to elect and dismiss the managers of the BNB, will include a statement that their mandate can be terminated prematurely only if the respective manager does not fulfil anymore the conditions required for the performance of his duties or if he has been guilty of serious misconduct.

In this way the only two grounds for premature dismissal of the Governor of a national central bank as per Art. 14.2 ESCB Statute (with its meaning widened through the discussed latitudinarian interpretation as being applicable also with regard to the other members of the management body of the central bank) would be enshrined in the Constitution itself. In this way we could build a bridge to the already existing power of the Constitutional Court to adjudicate on the constitutionality of laws and *other acts* of the National Assembly, as well as of acts of the President. A premature dismissal, which is not based on one of the two reasons in the extended version of Art. 84, point 8 of the Constitution of the Republic of Bulgaria (CRB), would already represent an infringement of the Constitution and accordingly would be submitted to the control of the Constitutional Court.

One drawback of this variant is the systemic place of the reasons for dismissal – in Art. 84 CRB, which deals exclusively with the powers of the Parliament. A question may arise whether the dismissal of a member of the Governing Council, belonging to the Presidential quota, on a basis different from those explicitly envisaged could also be submitted to control over its constitutionality.

Taking into consideration the complicated procedure for amending the Bulgarian Constitution, the realization of the above options remains a question for the future, probably in package with other constitutional revisions, imposed by the imperatives of the European integration. For the moment, the revised Law on the BNB reproduces the right of the Governor to appeal the decision for his dismissal before the Court of Justice of the European Communities (starting from the moment of accession of Bulgaria to the EU). What about the other members of the BNB Governing Council?

After a thorough interpretation of the Bulgarian Labor Code, one could reach the conclusion that its Art. 360 in fact is capable of providing the necessary protection. Here we have the general clause, stipulating that **all** labor disputes are to be dealt with by the courts. Of course, there are exceptions to this rule, enumerated in the second paragraph of the cited article, but it is just this drafting that in the final account provides the basis for the proposed interpretation. Par. 2 of

Art. 360 excludes from the scope of judicial control those labor disputes that are related to the dismissal of elective officials in the Executive, in non-governmental organizations, in political parties and movements, as well as members of the so-called “political cabinets” of the ministers. Since the enumeration is meant to be explicit and exhaustive, *per argumentum a contrario* it could be seen that the members of the BNB management do not fall in any of the above categories – consequently, their claims for illegal premature dismissal could be brought to the attention of the district courts on the basis of the general clause of Art. 360 of the Labor Code. Of course, it would be unusual (to say the least) to have the decisions of the Parliament or the President controlled by the district courts, but the subject matter of the dispute (a labor relationship) predetermines this curious outcome.

C/ It is again in line with the engagements undertaken by Bulgaria in its accession negotiations with the EU regarding the personal independence of the members of the BNB Governing Council that a revision of Art. 12, Par. 5 & 6 was executed – aiming to create similar guarantees against a conflict of interests for *all* the members of the Governing Council. According to the newly introduced construction, the Governor and the Deputy Governors may not engage in any other activity, other than teaching, or as members of the bodies in companies where the BNB participates, or in international organizations related to the BNB activities. They may perform a non-remunerative activity following a unanimous decision of the Governing Council insofar as there is no conflict of interest. The other three members of the Governing Council (the so-called “external members”) may not engage in any other remunerative activity at the BNB, work for banks, insurance companies, other financial institutions or in the executive, as well as perform any other activity which may create a conflict of interest. It could be seen how – despite the fact that the status and role of the two composing elements of the BNB Governing Council are not equal, since the “external members” have more or less inherited the function of the previously existing “Plenary Council” of the central bank, meant to express the public interest in the governance of the BNB – the “least common denominator” for all is now the absence of conflict of interest, while the restrictions for other occupations of the Governor and the three Deputy Governors are naturally stricter, because theirs is a full-time job with the central bank (the external members in principle participate only two times per month in the sessions of the Governing Council).

7. Practically Imposed Amendments

The initiatives for revising the statutory law of any central bank should be rare enough in order to ensure legal stability and certainty in this sensitive area. That is all the more important with respect to an act like the LBNB, which since 1997 fulfills – at least in the eyes of the general public – the prestigious role of something like an “economic constitution” of the country, guaranteeing

perseverance in pursuing financial stability and commitment to necessary, if sometimes painful, reforms. Just because it is not probable that the chance for another revision will come in near future, any legislator should use the opportunity to address through the amendments some less fundamental, but still important issues. The Bulgarian experience is not an exception in this sense.

1. In the context of the latest revision of the LBNB it was decided that the elaboration of special texts in the Law is needed for the sake of creating an appropriate regime for the detection of non-genuine or counterfeited banknotes and coins by the financial system and the role of the central bank in this process.

The creation of a National Analysis Center within the central bank fulfils one of the basic requirements of Regulation No. 1338/2001 of the EU Council, laying down measures necessary for the protection of the euro against counterfeiting. Closely related is also the requirement for all countries acceding to the EU to undertake the necessary measures for active participation in the efforts for preventing the circulation of counterfeit money on the part of credit and other institutions, engaged in accepting and distributing banknotes and coins as a professional activity. This could be achieved through the creation of a legal obligation for financial institutions to withdraw from circulation all received banknotes and coins regarding whose authenticity they have reasonable doubts, and to submit them to the competent national institutions empowered to identify, collect and analyze the technical and statistical information concerning the counterfeiting of money, in particular the euro. Essential composing element of these competent institutions (whose list should be brought to the attention of the ECB and the European Commission) is also the National Analysis Center.

Closely related to the provisions of Regulation 1338/2001 is the ECB Decision of November 8, 2001 on certain conditions regarding access to the Counterfeit Monitoring System (ECB/2001/11). In compliance with this Decision, Member States are expected to establish their own national centers on counterfeits within the relevant central banks and to create the function of a security administrator of the national center. This center must administer the access to the established by the ECB Counterfeit Monitoring System of the national analysis center and other competent authorities of the relevant Member State. On the basis of an arrangement with the ECB, the national centers on counterfeits will authorize the different levels of access to the Counterfeit Monitoring System. With this purpose the security administrator should create the necessary user names, different categories of users and different levels of access among the users of the Counterfeit Monitoring System.

The recent amendments to Art. 27 LBNB aim at building the precise normative mechanism for cooperation between the central bank and the other financial institutions relative to withdrawing from circulation of all Bulgarian or foreign banknotes and coins which have come under their control in whatever way and which are suspected of being non-genuine or having been counterfeited. This

regime has the advantage of being based on the already gathered informal practice for such cooperation (until recently the suspect money were retained by the commercial banks or exchange bureaus and sent with an accompanying protocol to the Issue Department of the BNB for analysis), as well as to create the needed legal ground for successful functioning of the National Analysis Center and of the future National Center on the Counterfeits.

According to the established procedure, the BNB, banks, financial houses, and exchange bureaus are required to retain for verification upon issuing a written document all Bulgarian and foreign banknotes and coins which have come under their control in whatever way which are suspected of being non-genuine or having been counterfeited. The BNB is proclaimed as the only competent authority for conducting verification and completing an expert assessment. If as a result of this assessment it has been established that the banknotes or coins are non-genuine or counterfeited, they are retained by the BNB without being redeemed or returned. The Law provides a normative delegation for the central bank to issue a by-law dealing with these issues in detail. The delegation was materialized through the new Regulation N 18 of the BNB on the Control over the Quality of Banknotes and Coins in Circulation.

2. Following the introduction of the euro, the obligation of the BNB under Art. 30 is reformulated – on demand, the central bank is bound to sell and purchase already not German marks, but *euro* against levs up to any amount within the territory of Bulgaria on the basis of spot exchange rates, which shall not depart from the official exchange rate by more than 0.5%, inclusive of any fees, commissions and other charges to the customer. A refined formulation of Art. 31, Par. 3 is adopted, providing that the lev equivalent of the gross international reserves (with the exception of the reserves under Art. 28, Par. 3, items 3 and 6), denominated in currencies other than euro cannot deviate by more than two per cent, both plus or minus, than the lev equivalent of the total monetary liabilities of the BNB.

3. Clearly accentuated are the functions of the BNB as overseer of the payment systems (Art. 2, Par. 4), as supervisor of other banks' activities in the country (Art. 2, Par. 6), as fiscal agent and depository of the State (Art. 43, Par. 1), as provider of bank service of the accounts and payments included in the single account system, on behalf and for the account of the Ministry of Finance (Art. 43, Par. 2). Art. 43, Par. 1 stipulates that the Ministry of Finance will pay the services under Art. 43, Par. 1–3 by virtue of concluded contracts at market conditions and prices of services – this highlighting another dimension of the central bank's independence from the Executive.

4. The revised Law introduces the notion for internal audit of the BNB and the prerogatives of the Chief Auditor are elaborated in compliance with the latest trends in audit practice (Art. 22). Art. 16 creates a new power for the Governing Council of the BNB – to be responsible for establishing and maintaining an

efficient internal control system at the BNB and its subsidiaries adequate to the inherent risks to its activities.

5. A correction was needed also in the existing wording of Art. 61 LBNB – “Administrative Penal Liability”. The clause envisaged liability only for “individuals having breached this Law...”. Thus it was not provided for an identical sanction in case of breach of the *by-laws* governing the Law’s enactment. In addition, due to the inflationary processes characteristic for the beginning of 1997 (when the initial version of the Law was drafted), the sanction’s amount was defined through reference to the minimum monthly salaries as determined by the Council of Ministers by the date of committing the violation of the LBNB – the fine was up to the amount of 6 to 35 minimum monthly salaries. Taking into account the achieved financial stabilization, the normative practice in Bulgaria adopted lately the approach to directly fix the amount of pecuniary liability. In addition, the new version aims at differentiating between the pecuniary liability of natural persons, on the one hand, from that of legal entities and sole proprietors, on the other. That is why the following wording could be found now in Art. 61:

“*Art. 61* Whoever commits or permits the commitment of a violation of this Law or legislative acts governing its enactment shall be fined in the amount of BGN 500 to 3000, unless this violation constitutes a criminal offence. If the offender is a sole proprietor or a legal entity, a property sanction shall be imposed in the amount of BGN 5,000 to 30,000.”

8. Some Lessons to Be Learnt from the Reform

On the background of the explored Bulgarian reform concerning the central bank’s statutory law, one should be able to reach several conclusions.

First, to formulate legal guarantees for central bank independence – and to pass them through the national legislature – appears slightly easier when the right of the central bank to conduct monetary policy is initially restricted (e.g. by means of a currency board arrangement). That is nothing to do with the somewhat cynical wisdom that independence is easily granted to an entity on which nothing really depends. Just on the contrary – the case of Bulgaria proves that the real autonomy should not come as a “gift” to the central bank, but as a duly, hard-earned remuneration for its performance.

If compared in this sense with the independence of the judiciary, several interesting conclusions could be drawn – some in broadly theoretical, some in purely national context. Friedman (1962) compares the role of an independent central bank in the economic system to the role of an independent judiciary in a legal system. The judiciary is isolated from the ever-changing political pressures in order to ensure the impartial interpretation of legal acts according to their proper sense and long-term purposes (Landes and Posner, 1975). The same is the ideology behind the creation of independent central banks – to assign the determination and

exercise of monetary policy to an institution with a long time horizon that is not subject to short term political influence (Miller, 1998). All the said being very convincing, one should also be aware of some national peculiarities. Immediately after the liberalization of political life in 1989–1990, one of the first tasks of the Bulgarian legislator was to create (through the Constitution of 1991) iron-clad guarantees for the independence of judges. Still, the judiciary of the Communist system had not provided any especially conclusive evidence for its maturity, authority or competence. The independence came as something of a wind-fall for the judicial system, just because that was the case in those Western countries whose example Bulgaria was determined to follow. The result was that 15 years later the greatest challenge for Bulgaria in its way towards EU membership is how to create legal safeguards for the proper functioning of the judiciary, whose frequently capricious decisions and sluggish adjudication (there are precedents of ordinary civil cases having to wait between 5 and 7 years for the final decision) are in deep contrast with – and perhaps an unexpected and bitter fruit of – the easily accorded independence and immense power. That represents merely another proof of how apt is the maxim adduced by Reader (2004) that “power corrupts, and absolute power corrupts absolutely”. The case with the Bulgarian central bank is just the opposite: it received its independence after 15 years of incessant efforts for defending the basic principles of market economy, after a serious systemic crisis and especially after its overcoming through the uncompromising discipline of the currency board. This should be one of the basic lessons for any reforming legal system – to implement the sacrosanct tenets of EU Law regarding independence only when the relevant institution and the society itself are mature enough to face the incredible challenge of freedom.

An important aspect of this bold endeavor is the strict accountability. It is the transparency of the highly independent central bank that appears as the optimal way for achieving the delicate balance between the two apparently disparate goals of independence and accountability. Cechetti (1999) stresses upon the fact that when central banks announce targets for monetary policy or explain their policy before an elected body, their behavior is conducive to transparency in policy and accountability to the public.

At the same time, we must remember the conclusion of several researchers (Miller, 1999; Hadjiemmanuil, 1997) that the independence should be full only with regard to monetary policy. Other usual fields of central bank’s activity – banking supervision, payment systems oversight, control over the foreign exchange regime – cannot be completely insulated from the scope of some external control (notably, on the part of the judiciary).

When envisaging the primary objective of the central bank, the legislator naturally should follow the common model of the ESCB Statute, but without forgetting to implicitly link this main purpose with the real central bank’s prerogatives provided by the law in force. Otherwise, a deep gap might occur

between the stated purpose and the available tools for its achievement, which could trigger certain legal nihilism.

Even so politically motivated and usually jealous for its prerogatives institution as the national Parliament could be convinced to abandon voluntarily an important lever of influence over the central bank as the adoption of its annual budget, if the bank has already gained the public confidence with proper managerial decisions and has balanced the autonomy in defining its own expenses with ensuring a maximal degree of transparency and responsibility.

The revision of the law on the central bank, while engendered by the imperatives of the integration with the EU, should be responsive to the day-to-day practical needs of the institution and “pack” those amendments with the general reform that is in line with the EU legislation.

Finally, no one should forget that legal regulation is an ever developing notion, even in the conservative area of central banking. If the achievement of normatively protected central bank’s independence is considered as a prerequisite for joining the EU, the following challenge already emerges on the horizon – the adherence of a “new” EU member state to the Economic and Monetary Union. In his thoroughly researched paper Fatur (2004) outlines a possible procedure for such a country to join the third stage of the EMU and an eventual time schedule for the fulfillment of the convergence criteria in the new Member States. This process will inevitably require further revisions in the legal framework applicable to the central bank. It will be a challenging, but rewarding effort.

Given the fact that we already addressed the role of the central bank in the context of a systemic crisis through a literary analogy (the novel of Mario Vargas Llosa), this paper may be concluded in the same way. Leo Tolstoy included in his famous novel “Ana Karenina” the memorable phrase that “All the happy families are similar, all the unhappy ones are unhappy in their own way.” This maxim is applicable also to central banks. Each of the crises they have to survive has its unique peculiarities, while the solutions are quite similar. They always lead to ensuring real independence of the central bank. Perhaps that is not the best approach, but at any rate nothing better has been invented up to now.

References

- Alesina, Alberto, and Lawrence Summers, 1993, “Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence”, *Journal of Money, Credit and Banking*, (May), 151.
- Balyozov, Zdravko, 1999, “The Bulgarian Financial Crisis of 1996–1997” (Balgarska Narodna Banka – Discussion Paper 7/1999).

- Barenboim, Peter, 2001, "Constitutional Economics and the Bank of Russia", 7 *Fordham Journal of Corporate and Financial Law* 159.
- Brentford, Peter, 1998, "Constitutional Aspects of the Independence of the European Central Bank", 47 *International & Comparative Law Quarterly* 75.
- Cecchetti, Stephen, 1999, "Accountability of the Central Bank for Monetary Policy", in *Current Developments in Monetary and Financial Law*, Vol. 1 (Washington D.C.: International Monetary Fund, 1999).
- Deller, Patrick, 1999, "The European System of Central Banks: Quo Vadis?", 21 *Houston Journal of International Law* 170.
- Fatur, Andrej, 2004, "What Challenges Do the Central European and Mediterranean States Face In Trying to Join the Third Stage of European Monetary Union?", 28 *Fordham International Law Journal* (Fifteenth Annual Philip D. Reed Memorial Issue) 145.
- Fisher, Stanley, and Guy Debelle, 1994, "How Independent Should a Central Bank Be?" in *Goals, Guidelines, and Constraints Facing Monetary Policy Makers*, Federal Reserve Bank of Boston, Conference Series No. 38, 195.
- Friedman, Milton, 1962, "Should There Be an Independent Monetary Authority", in *In Search of a Monetary Constitution* (L. B. Yeager ed., 1962).
- Gabilondo, Jose M., 2005, "Sending the Right Signals: Using Rent-Seeking Theory to Analyze the Cuban Central Bank", 27 *Houston Journal of International Law* 483.
- Goebel, Roger, 1998, "European Economic and Monetary Union: Will EMU Ever Fly?" 4 *Columbia Journal of European Law* 250.
- Gormley, Laurence, and Jakob de Haan, 1996, "The Democratic Deficit of the European Central Bank", 21 (2) *European Law Review* 95.
- Grilli, Vittorio, Donato Masciandaro and Guido Tabellini, 1991, "Political and Monetary Institutions and Public Financial Policies in Industrial Countries", *Economic Policy: A European Forum*, Vol. 6 (October), 342.
- Guitian, Manuel, 1995a, "Central Bank Independence: Issues and Diversity of Models", a paper prepared for a workshop on Independence and Accountability: The Role and Structure of the South African Reserve Bank, January.
- Hadjjemmanuil, Christos, 1997, "European Monetary Union, the European System of Central Banks, and Banking Supervision: a Neglected Aspect of the Maastricht Treaty", 5 *Tulane Journal of International and Comparative Law* 105.
- Hidalgo, Luis Jacome, 2003, "Central Banks and International Financial Volatility", in *Current Developments in Monetary and Financial Law*, Vol. 2 (Washington D.C.: International Monetary Fund, 2003).
- IMF, "Elements of Central Bank Autonomy and Accountability", 1998, IMF – Monetary and Exchange Affairs Department, Operational Paper 98/1.

- Johnson, Karen H., 2003, “Central Bank Responsibility for Exchange Rate Policy and Implementation”, in *Current Developments in Monetary and Financial Law*, Vol. 2 (Washington D.C.: International Monetary Fund, 2003).
- Landes, William M., and Richard A. Posner, 1975, “The Independent Judiciary in an Interest-Group Perspective”, 18 *Journal of Law and Economics* 875.
- Lastra, Rosa Maria, 2000, “The Division of Responsibilities Between the European Central Bank and the National Central Banks Within the European System of Central Banks”, 6 *Columbia Journal of European Law* 167.
- Lavrano, Nikolaos, 2004, “The Limited Functional Independence of the ECB”, 29 *European Law Review* 1.
- Llosa, Mario Vargas, “Conversacion en La Catedral”, *Editorial Seix Barral, S.A.*, 1979.
- Lybek, Tonny, 1999, “Central Bank Autonomy, and Inflation and Output Performance in the Baltic States, Russia, and Other Countries of the Former Soviet Union, 1995–97”, IMF Working Paper 99/4 (Washington D.C.: International Monetary Fund).
- Lybek, Tonny and JoAnne Morris, 2004, “Central Bank Governance: A Survey of Boards and Management”, IMF Working Paper 04/226 (Washington D.C.: International Monetary Fund, 2004).
- Miller, Geoffrey P., 1998, “An Interest-Group Theory of Central Bank Independence”, 27 *Journal of Legal Studies* 433.
- Miller, Geoffrey P., 1999, “External Review of Decisions by Central Banks”, in *Current Developments in Monetary and Financial Law*, Vol. 1 (Washington D.C.: International Monetary Fund, 1999).
- Muehring, Kevin, 1991, “European Monetary Union on the Line”, *Institutional Investor*, Oct. 1991, 35.
- Neumann, Manfred J. M., 1991, “Precommitment by Central Bank Independence”, 2 *Open Economies Review* 95.
- O’Neil, Kathleen, 1999, “Financial Accountability of the Central Bank – Internal and External Controls”, in *Current Developments in Monetary and Financial Law*, Vol. 1 (Washington D.C.: International Monetary Fund, 1999).
- Reader, Shaun A., 2004, “Moving Forward, Never Backwards: Preventing Fraud in the European Union and Defining European Central Bank Independence”, 27 *Fordham International Law Journal* 1509.
- Schinasi, Garry J., 2003, “Responsibility of Central Banks for Stability in Financial Markets”, in *Current Developments in Monetary and Financial Law*, Vol. 2 (Washington D.C.: International Monetary Fund, 2003).
- Толстой, Лев Николаевич, “Анна Каренина”, Ленинград, “Художественная литература”, Ленинградское отделение, 1979.
- Webb, Steven B., and Bilib Neyapti, 1992, “Measuring the Independence of Central Banks and Its Effect on Policy Outcomes”, *The World Bank Economic Review*, Vol. 6, No. 3, 352.

Zilioli, Chiara, and M. Selmayr, 1999, "The External Relations of the Euro Area: Legal Aspects", 36 *Common Market Law Review* 273.

Zilioli, Chiara and M. Selmayr, 2000, "The European Central Bank: an Independent Specialized Organization of Community Law", 37 *Common Market Law Review* 591.

The Structure and Functions of the Türkiye Cumhuriyet Merkez Bankası

D. Derya Yeşiladali

Türkiye Cumhuriyet Merkez Bankası

Abstract

The history of the Türkiye Cumhuriyet Merkez Bankası is traced back to 1930. The Bank was established as a joint stock company by the Central Bank Law No.1715 of 1930 which is the first central banking law of the Turkish Republic. The logic behind its establishment as a joint stock company was to prevent political influences upon its operations and policies. The said Law was repealed by Law No.1211 of January 14, 1970 and the Bank is presently governed by Law No.1211. This Law has undergone various modifications and amendments. The most recent changes made in 2001 were aimed at aligning the Law to the Maastricht requirements.

In this context, the amendments were aimed to emphasize and put “price stability” into a statutory footing. It is stipulated in the Law that the “primary objective of the Bank is to achieve and maintain price stability”. The Bank is also empowered to determine and implement monetary policy in order to achieve price stability and to fight inflation. Instrumental independence is granted through the recent amendments. In addition to this, the Bank enjoys absolute operational autonomy in exercising the powers and carrying out its duties. Financing government deficits through the Bank is prohibited, thus the independence of the Bank is enhanced, and political influence and interference is obstructed.

The term of office of Vice Governors is increased from three to five years. The changes, the most salient ones referred, have enhanced the independence of the Bank. Consequently, the requirements for an independent central bank have been firmly put into a statutory footing and most of the requirements of the Maastricht criteria are achieved so that Turkey will be able to accomplish her long and onerous odyssey for full membership to the European Union (EU).

1. Introduction

Turkey's relations with the EU is traced back to 1959. Although there were some turbulent periods in this relationship, with the Helsinki Summit in 1999 and acceptance of Turkey as a candidate country, the relations smoothed out. Especially, after the December Summit in 2004, the decision of the EU Council to initiate accession negotiations with Turkey on October 3, 2005 put the relations in another dimension. A dimension that will pave the way for eventual Turkish full membership to the EU.

It is known that the Helsinki Summit of 1999, confirmed Turkey's candidacy on a similar footing as the previous candidates and new Member States. The first issue being the fulfillment of the Copenhagen Criteria has been deemed to be met. The second issue will be the fulfillment of the Maastricht Criteria, which are required for entry to the Economic and Monetary Union (EMU).

We all know that the criteria relate to price stability, public finances, exchange rate stability and long term interest rates. However, in addition or an integral issue to the criteria, there is yet another requirement to be satisfied: the central bank independence. In other words, a candidate country to qualify for full membership has to ensure that its Central Bank legislation guarantees full institutional, personal, functional and financial independence.

In this context, this paper shall evaluate and elaborate the legal basis, organizational structure and independence of the Türkiye Cumhuriyet Merkez Bankasi vis-à-vis the Maastricht Criteria.

2. Legal Basis

The Türkiye Cumhuriyet Merkez Bankasi (Bank) was established in 1930 through the Central Bank Law No.1715, which is the first central banking law of the Turkish Republic. Since 1930, by the influence of economic developments and circumstances, the Law has undergone major changes. The said Law was repealed by Law No.1211 of 14 January, 1970 (Law), the current legislation governing the Bank, which has been modified in 2001 by the Amending Law of 25 April, 2001 with the objective of complying with the Maastricht Treaty (Treaty) and the Statute of the European System of Central Banks and of the European Central Bank (Statute). The modifications were quite significant, as 14 articles were changed, 7 articles were repealed and a brand new article was introduced.

It is emphasized by the amendment that the Bank is the ultimate body authorized and responsible for the determination and implementation of monetary policy. In order for the Bank to achieve an effective money supply and liquidity control for price stability, the monetary policy has to be determined and pursued

exclusively by the Bank. The said change in the Law is in compliance with Article 108 of the Treaty and Article 7 of the Statute.

With the new provision (Article 4) it is explicitly emphasized that the Bank will, with the objective of price stability, be authorized and empowered to utilize monetary policy instruments described in the Law and will also be authorized to directly determine and implement other monetary policy instruments that it deems appropriate.

The amendment was aimed at laying down a statutory commitment to achieving and maintaining price stability as well as giving a considerable autonomy to determine and implement monetary policy.

Accordingly, the basic logic behind the recent amendment through Law No. 4651 was to reconcile the practices regarding monetary policy with changing economic conditions. Therefore, the amendment may be perceived as a breakthrough in many aspects and is likely to pave the way towards a more effective and sound monetary policy that will satisfy an important prerequisite for sustainable and robust economic growth.

Thus, the Central Bank will enjoy instrumental independence that enables the Bank to conduct transactions consistent with its primary objective through monetary instruments on its own discretion.

I would briefly like to refer to the monetary policy instruments described in Article 52 of Law No. 1211. The Bank, within the framework of monetary policy targets, carries out open market operations. However, in accordance with Article 52 open market operations may not be conducted to provide credit facilities to Treasury, public institutions or to other establishments.

On the other hand, the Bank may, within the framework of its monetary policy to determine the value of Turkish lira against other currencies, execute transactions such as spot and forward purchase and sale of foreign exchange and banknotes, foreign exchange swaps and other derivatives transactions.

In addition, the Bank manages the gold and foreign exchange reserves of the country consistent with the monetary policy targets and practices. The Bank may, with this objective and in compliance with the terms and conditions to be determined by it, perform all kinds of banking activities in the domestic and international markets covering spot or forward purchase and sale of gold, foreign exchange, securities and derivatives products, as well as lending and borrowing operations, by taking into consideration the security, liquidity and return priorities respectively.

Besides this the Bank may, within the scope of principles to be determined by it, accept commercial bills and documents to be presented by banks for rediscount, provided that they bear at least three signatures of solvent persons and have a maximum of 120 days for their maturity. The types of commercial bills to be accepted for rediscount and other conditions shall be stipulated by the Bank. The maximum amount of loans to be extended in accordance with this article and their

limits pursuant to credit types shall be determined by the Bank by taking monetary policy principles into consideration.

The Bank may also grant advances against the bills that it may accept for rediscount. Furthermore, the Bank determines the procedures and conditions of reserve requirements and liquidity requirement for banks, special finance institutions and other financial institutions.

However, in accordance with second paragraph of Article 56, the Bank may not extend credits and grant advances except for the operations authorized by this Law, and the credit to be extended and the advance to be granted may not be unsecured or without cover. This provision is on its own a big step towards increasing the independence of the Bank.

The changes affected both political and economic indicators of independence. In other words, modifications made in 2001 brought about a remarkable change in the degree of independence.

Accordingly, we can say that the amendments made regarding operational independence, accountability, transparency and the introduction of a monetary policy committee were aimed at complying with the economic developments and central banking norms agreed upon by the EU, and within the framework of the Statute. Therefore, I would like to make an evaluation of the independence of the Bank in light of the changes that have been put on a statutory footing.

3. Independence

3.1 Operational Independence

With the recent amendment in Article 4 of the Law, which sets forth the fundamental duties and powers of the Bank, it is stated that the primary objective of the Bank is to achieve and maintain price stability. Thus functional independence is substantiated in Article 4 of Law No.1211.

Accordingly, first paragraph of Article 4 has been incorporated to explicitly state that the Bank's primary objective is to achieve and maintain price stability

shall determine the monetary policy that it shall implement along with the monetary policy instruments that it is going to use on its own discretion.

As the primary objective of the Bank is stipulated as to maintain price stability, the Bank determines the monetary policy to be implemented and the instruments thereof on its own discretion. In other words, the Bank is the ultimate body authorized and responsible in determining and implementing monetary policy. The operational independence is emphasized by paragraph 5 of Article 4, which stipulates that the Bank is autonomous in exercising the powers and carrying out the duties granted on its own responsibility.

We have to clarify that, as the Bank is a legal person, all decisions are taken by the decision-making bodies and exercised by the governing bodies of the Bank.

Whenever a reference is made to the Bank, it should be understood as the decision making bodies of the Bank.

However, Article 4/II-b, stipulates that the inflation target will be determined together with the government.

At this point, it is required to make a clarification. First of all, in accordance with Article 22/A, the Monetary Policy Committee of the Bank determines the principles and strategy of monetary policy. Second, within the framework of these principles and strategy, the Bank determines the inflation target together with the government. Consequently, in compliance with the inflation target which is already drawn up consistent with the monetary strategy of the Bank, the Bank determines the monetary policy on its own discretion.

The new provision states: “The Bank shall determine the inflation target together with the government and in compliance with the said target shall adopt monetary policy. The Bank shall be the ultimate body authorized and responsible to implement monetary policy.”

The determination of the inflation target exclusively by the government is considered to be against democratic norms by most economists. Taking this into consideration, the determination of the inflation target together with the government, is based on the consideration that the harmonious and mutual cooperation of the Bank with the government on the implementation of monetary policy will create more beneficial consequences otherwise, the economic program and the activities of the government could affect the inflation rate. In particular, the incomes policy to be implemented by the government, debts for financing public deficits and the quantity (volume) of public expenditures could alter the interest rates and the expectations of market participants. In this context, the determination of the inflation target jointly with the government will lead the government to be more precautionous on the consequences of the economic program which might affect the inflation and therefore, this will help to attain the necessary harmony for price stability.

Since the government is bound by the monetary strategy of the Bank in the determination of the inflation target, the implementation of the relevant provisions should not impede the independence of the Bank.

However, as this is criticized in the 2004 Regular Report, the required amendments will be made in order to achieve full compliance with Article 108 of the Treaty.

It should also be considered that, by full membership to the EU, as all the Member States will be subject to the same criteria, the inflation will no more be determined together with the government.

3.2 Personal Independence

The general concept of personal independence is a means to secure the independence of the members of the decision making bodies and it is stipulated by longer terms of office.

Our Law, vis-à-vis the term of office of the Governor, was already in compliance with the Treaty and the Statute prior to the amendment. In accordance with Article 25, the Governor is appointed for a renewable term of five years by a decree of the Council of Ministers. This term of office is to be in line with the minimum term as established in Article 108 of the Treaty and Article 14.2 of the Statute.

Pursuant to Article 29, the term of office of Vice Governors is also five years. Therefore, security of tenure for Vice Governors is also in line with the relevant articles of the Treaty and Statute.

However, the term of office of Board Members is established as three years in Article 20 and one third of them is renewable. This Article might be regarded as being a bit problematic. The determination of tenure of Board Members as three years is based on the relevant provision of the Turkish Commercial Code which stipulates: “Board Members shall be elected for a maximum period of three years.” This is because the Bank is established as a joint stock company therefore it is also subject to the provisions of private law.

The determination of the term of office of the Board Members as five years will reinforce and contribute to the individual independence.

Within this context prior to EU membership Article 20 of Law No.1211 which establishes the term of office of the Board Members needs to be modified to be in line with the terms of office of the Governor and Vice Governors, and also to be in compliance with the Treaty and the Statute.

The members of the decision-making bodies are eligible to be reelected so it is in compliance with the system.

The election of the Governor by a decree of the Council of Ministers and the Vice Governors by a joint decree is not a contradiction to the Statute as there is a similar situation in ECB where the Members of the Governing Council are appointed by a decree of the Member States, in other words politically. Therefore, the election and term of office of the Governor and Vice Governors are not incompatible with the Statute.

Pursuant to the first paragraph of Article 25, the Governor is appointed for a renewable term of five years. On the other hand, the grounds for the dismissal of the Governor is stipulated in Article 28 of Law No.1211 which gives protection against the arbitrary dismissal of Governors, by stating that the Governor may be relieved from office only if he /she violates the prohibitions stated in Article 27 and if there is no longer any possibility for him/her to perform the duties entrusted by the Law.

Article 27 states: *“The duties of the Governor may not be reconcilable with any other duty outside the Bank whether of a legislative, official or private nature unless otherwise permitted by a special law. Furthermore, the Governor shall not be allowed to engage in trade, nor shall he become a shareholder in banks or companies. Duties in charitable associations and in foundations with charitable, social or educational purposes and partnership in non-profit-making cooperative companies are excluded from this provision. It shall not be considered a violation of the provisions of the first paragraph if the Governor assumes duties at inter-ministerial committee meetings held at the level of ministers and undersecretaries.”*

3.2.1 Security of Tenure of the Decision Making Bodies

The Governor of the Bank is appointed for a term of five years. Similarly, pursuant to Article 29 of Law No.1211, the term of office of Vice Governors is five years and the same provision which is applicable for the dismissal of the Governor applies to the Vice Governors as well.

Board Members may be dismissed either if they act against paragraph 2 of Article 19 of Law No.1211 or pursuant to relevant provisions of Commercial Code through majority votes of the General Assembly.

Paragraph 2 of Article 19 states: *“The duties of the Members may not be reconcilable with any other duty outside the Bank whether of a legislative, official or private nature unless otherwise permitted by a special law. Furthermore, these Members shall not be allowed to engage in trade, nor shall they become shareholders of banks or companies. Duties in charitable associations and in foundations with charitable, social and educational purposes and partnership in non-profit-making cooperative companies are excluded from this provision.”*

Article 22/A of Law No.1211 stipulates that the term of office of the Monetary Policy Committee Member to be appointed by a joint decree is five years and is also subject to the prohibitions cited in Article 19 which applies to Board Members. Accordingly, if those prohibitions are violated, the Member is dismissed from the Committee. For this reason, security of tenure of the members of the decision making-bodies of the Bank might be identified as not being in line with Article 108 of the Treaty and Article 14.2 of the Statute.

3.2.2 Right of Judicial Review

Governors, Vice Governors and other members of the decision-making bodies may not be dismissed for reasons other than those mentioned in the Organic Law of the

Bank and in other relevant legislation. National law foresees and warrants that members of decision-making bodies have a right to have any dismissal decision reviewed by an independent judicial court.

In accordance with the Constitution and Law on Administrative Trial Procedures, “legal proceedings may be initiated against all actions and operations of the administration” and “those whose personal rights are violated by any administrative action or operation” have the right to file a suit at the Administrative Tribunals. If the Governor, Vice Governors or a Member of the Monetary Policy Committee, who are appointed by a joint decree, are discharged from their offices, the above mentioned provisions shall establish the grounds to file a suit at the administrative courts.

Election or discharge of the Board Members are subject to and governed in accordance with the provisions of private law, that means the procedure concerning the election and discharge of the said Members is not an administrative operation. In the event of the dismissal of Board Members, in accordance with the second paragraph of Article 381 of the Turkish Commercial Code the member concerned or shareholders may file a suit for the annulment of the General Assembly decision.

In accordance with Article 14.2 of the Statute, the Governor and Board Members of national central banks have a right of judicial review, which reinforces their independence. In Law No.1211 there is no corresponding provision. However, in accordance with the Constitution and Law on Administrative Trial Procedures, “legal proceedings may be initiated against all actions and operations of the administration” and “those whose personal rights are violated by any administrative action or operation” have the right to file a suit at the Administrative Tribunals. If the Governor, Vice Governors or a Member of the Monetary Policy Committee, who are appointed by a joint decree, are discharged from their offices, the above-mentioned provisions shall establish the grounds to file a suit at the administrative courts.

3.2.3 Safeguards against Conflicts of Interest

Pursuant to Articles 19, 22A, 27 and 29 of Law No.1211 respectively, Governors, Vice Governors and other members of the decision-making bodies of the Bank may not have any duty outside the Bank whether of a legislative, official or private nature unless otherwise permitted by a special law. Furthermore, the said persons are not allowed to engage in trade, and they cannot become shareholders of banks or companies.

Article 21 of the Law stipulates that Board Members may neither participate in discussions nor cast votes on credit issues concerning themselves or persons with whom they have a link of interest or kinship in the degrees stated in the Turkish Code of Civil Procedure.

3.3 Institutional Independence

Institutional independence is a feature of central bank independence which is expressly referred to in Article 108 of the Treaty and Article 7 of the Statute. Accordingly, the institutional independence, which prohibits any central bank from seeking or taking instructions from governmental institutions or bodies and which also prohibits governmental institutions or bodies from influencing the decision-making bodies of the central bank, is defined in Article 4 of Law No.1211 corresponding to Article 108 of the Treaty and Article 7 of the Statute respectively.

It is stipulated in the said Article that the Bank shall enjoy absolute autonomy in exercising the powers and carrying out the duties granted by the law under its own responsibility. This provision explicitly states that no authority or office may make any suggestions or give instructions in a way to influence the decisions of the Bank.

Within the context of institutional independence, the third parties do not have a right to approve, suspend, annul, defer or censor decisions of the Bank.

On the other hand, in accordance with Article 22/A of Law No.1211, the Undersecretary or Deputy Undersecretary of the Treasury may attend the Monetary Policy Committee meetings, without a voting right.

However, this does not impede the independence of the Bank. This practice is a natural consequence of the structure of the Monetary Policy Committee, which is a connecting forum for the policies to be conducted by the government and the Bank jointly.

In accordance with Article 26/2 the Prime Minister shall act as an arbitrator in the event of a disagreement between the Governor and the Board.

This might create a misunderstanding, however this does not infringe the institutional independence of the Bank for the “arbitrator” is a word chosen by the Legislator but it is in fact meant to be “a mediator”. The idea was the mediation of the Prime Minister. There has never been an incident to implement this article. Accordingly, this article has never been exercised.

Article 42 of Law. No.1211, which establishes that the Prime Minister may have the operations and accounts of the Bank audited and the Prime Minister may request any information in this regard from the Bank.

The first paragraph as stated above, provides for a special audit which adds to the audit of the Audit Committee and to the audit by external auditors. Although the said audit neither limits in scope nor in objective, of the independence of the Bank, the Prime Minister’s power to conduct investigations might be perceived as putting the decision-making bodies in a position where they might be assumed to be subject to external influence. The actual exercise of investigative powers could be understood as to place the Bank and its decision-making bodies under pressure, which might create arguments questioning the independence of decision-making required by Article 108 of the Treaty.

However, the said investigation is not and should not be understood as to impair the independence of the Bank. That is because, the Prime Minister may have the transactions and accounts of the Bank audited, but the said audit is not a general audit that is carried out periodically. Indeed it is an audit performed by the Investigation Board of the Prime Ministry in the event of a concrete situation. The said audit is of a pre-investigation nature, which is conducted by the experts of the subject in order to ensure a more sound investigation to be carried out by prosecutors.

On the other hand, the third paragraph of Article 42, stipulates that the Governor shall submit a report to the Council of Ministers on the operations of the Bank and the monetary policy followed and to be followed, each year in April and October and the last paragraph of the same Article states: “The Bank shall submit information to the government in writing and inform the public, disclosing the reasons of incapability to achieve the determined targets in due time published or the occurrence of the possibility of not achieving and the measures to be taken thereof.”

Regulations pertaining to the Bank’s activities described in the third and last sub-paragraph of Article 42 and, to monetary policy implemented and to be implemented in the future, which aim to provide information to the Council of Ministers and Planning and Budget Commission of the Turkish Grand National Assembly periodically are meant to reinforce the transparency and accountability of the Bank. It is quite clear that the said provisions do not stipulate that the Bank is required to request opinions of the said bodies before taking relevant decisions.

Article 58 establishes: “The Bank shall, prior to the meeting of the General Assembly, submit to the Prime Ministry the balance sheet and the income statement along with the annual report to be prepared as of the of each calendar year and...”

The Turkish Commercial Code does not have a provision imposing an obligation to forward the balance sheet, profit and loss account and, the annual report to the shareholders. However, it is stipulated that the said documents shall be made available to the shareholders at the head office and branches and, copies of profit and loss account and the balance sheet may be furnished upon request. In line with this provision, it is stipulated in the organic Law of the Bank, that the said documents shall be delivered to the Treasury and the balance sheet shall be published in the Official Gazette to make it available to the shareholders and also to enhance public disclosure.

In summary, by this provision it is envisaged to ensure a more sound audit by the shareholders and to offer them an opportunity to exercise their participation rights more efficiently at the General Assembly and thus reinforce transparency to public. This provision neither sets forth an obligation to require the opinion of the Prime Minister in advance nor implemented as such.

Consequently, within the context of institutional independence, the third parties do not have a right to approve, suspend, annul, defer or censor decisions of the Bank.

3.4 Financial Independence

One of the requirements for the central banks to implement their monetary policies is the existence of legal provisions securing their financial independence. We can talk about the financial independence of central banks when there are legal provisions prohibiting the direct or indirect utilizations of the central bank resources.

In accordance with Article 21.1 of the Statute, which establishes the financial independence of the ECB and national central banks, credit facilities and overdrafts to the government, public institutions or public undertakings are prohibited. Accordingly, by abolishing Article 50, which used to make it possible for the Bank to finance the Treasury with short-term loans, and by amending Article 56 to read as, “The Bank can not give loans to the Treasury and public institutions and organizations, can not retail debt securities issued by the Treasury and public institutions and organizations from the primary market. The Bank, can not advance any money or give loan, except for the authorized transactions foreseen by the Law, all kind of advance and loans can not be unsecured and without cover, the Bank can not be a guarantor in any way and can not provide security except for the transactions related with itself”. In accordance with the above-mentioned Articles, it is impossible to provide short-term advance to the Treasury and public institutions and organizations and to purchase debt securities of public institutions from the primary market. Therefore, we can say that, through the amendments of Law No.1211 the Bank is prevented and prohibited from financing the Treasury and public institutions due to budget deficits and duty losses.

However, it is argued that the Bank has to take certain measures to align Articles 40/I(a) and 40/I(b) of its Law with the *acquis communautaire* Article 40/I(a) stipulates: “The Bank may, as the lender of last resort, provide daily or end-of-day credit facilities to the system against collateral so as to eliminate the technical payment problems which may obstruct the efficient functioning of the financial markets, and the temporary liquidity shortages that may cause interruption in the payment system.”

The above mentioned Article establishes that these instruments are basically used in order to ensure the smooth operation of the payment systems. Through daily or end-of-day credit facilities, commercial banks, can apply to the Bank and since these credits are paid back at the end of the same day, does not affect daily liquidity management or debt management of the Treasury. On the other hand in the Statute, usage of these kind of credits are not prohibited. In addition to that, in a

Council Regulation, it is stated that the daily credits extended to the public sector are not considered as granting advance to the public institutions.

Article 40/I(b), states: “The Bank shall be authorized to grant advance to the Savings and Deposits Insurance Fund (SDIF) in accordance with sub-paragraph (b) of paragraph 5 of Article 15 of Banks Act No: 4389, under extra-ordinary conditions and in cases when the resources of the Fund are insufficient, upon the request of the Banking and Auditing Institution. The maturity, amount, repayment procedures and conditions, the interest rate of the advance granted and other issues shall be determined by the Bank in consultation with the Banking Regulation and Auditing Institution.”

In cases when the sources of the Fund are insufficient, the Fund shall not be able to fulfil its task of insurance; shall not be able to remedy the weak financial structure of those banks and thus, the weakness of those banks shall continue to effect the financial markets. And this will create a loss of confidence to the system and will result in withdrawals of deposits also from the sound banks, and consequently will violate financial stability.

Although these advances are granted only under extraordinary conditions, the existence of such an advance channel between the Bank and SDIF would create an impression that the duty of fund transfer of the Treasury is instead done by the Central Bank. However, in accordance with Article 168 of the Banking Act Bill, Article 40/I (b) is repealed. In other words the criticized provision will no more exist upon the enactment of the Banking Act Bill. Accordingly, when the Banking Act Bill is enacted and in force Article 40 will be in compliance with and aligned to the Statute. This Bill will be enacted before the end of November 2005.

4. Conclusion

Some differences and incompatibilities with the Statute may seem to remain. However, we should keep in mind that the negotiations to sort out these differences and to reach full compliance have not yet even begun. Moreover, the amended Central Bank Law has gone a long way to ensure full independence of the Bank, which will no doubt make it easier for both sides to eliminate the minor issues in question.

Taking into consideration the previous experiences of the ten new Member States, or the “class of 2004” as referred, on their compliance with “Chapter 11. Economic and Monetary Union”, or the new name “Economic and Monetary Policy under Chapter 17”, I have no doubt that Turkey will also comply with this Chapter and close it within the shortest period of time.

References

- Başçı, Erdem – “Comments Made to Fiscal Policy Challenges, Sustainability of Public Finances and EU Accession – The Case of Turkey by Graham Scott”. Conference by the Central Bank of Turkey on Macroeconomic Policies for EU Accession, May 2005.
- Bayar, Fırat – “Turkey and European Economic and Monetary Union (EMU):One Step Further Following Accession”, *Hazine Dergisi*, No. 16, 2003.
- Buiter H. Willem – “To Purgatory and Beyond” Conference Paper, Challenges for Central Banks in an Enlarged EMU, February 20—21, 2004, Oesterreichische National Bank, Vienna.
- Elgie, Robert – “Central Bank Independence: What It is and How to Compare It”, Discussion Paper, Political Studies Association, 1995.
- European Central Bank – “The Monetary Policy of the ECB”. Frankfurt, 2004.
- Gökbudak, Nuran – “Central Bank Independence, the Bundesbank Experience and the Central Bank of the Republic of Turkey”, Discussion Paper No: 9610, March 1996.
- Lostra, Rosa, Maria – “European Monetary Union and Central Bank Independence”, Current Legal Issues Affecting Central Banks, Volume 4, IMF-Publication, March 1997.
- Lichtenstein, Lynthia C. – “European Monetary Union and European System of Central Banks – Current Legal Issues Affecting Central Banks, Volume 4, IMF-Publication, March 1997.
- Özatay, Fatih – “Monetary Policy Challenges for Turkey in European Union”, Presentation made at the Conference by the Central Bank of Turkey on Macroeconomic Policies for EU Accession, May 2005.
- Serdengeçti, N. Süreyya – “Recent Reforms in Central Bank Law”, *Economic Dialogue Turkey*, Issue 49, September 2001.
- Scheller K. Hanspeter – “The European Central Bank – History, Role and Functions”, ECB, October 2004.
- Regular Report on Turkey’s Progress Towards Accession – 2004.

Legal Independence of the Narodna Banka na Republika Makedonija

Toni Stojanovski

Narodna Banka na Republika Makedonija

In this presentation I would like to highlight the main aspects of the legal independence of the Narodna Banka na Republika Makedonija (NBRM) following the concept defined by the European Monetary Institute (EMI), which was further refined through the opinions of the European Central Bank (ECB). Before I address this very important issue in the process of preparation of the NBRM for joining the European System of Central Banks (ESCB), let me briefly go through some historical facts about the Republic of Macedonia and its European integration process.

The Republic of Macedonia gained its political independence after the referendum held on 8 September 1991. The monetary independence came on 26 April, 1992, with the enactment of:

- The Law on the National Bank of the Republic of Macedonia establishing the NBRM as a Central Bank of the Republic of Macedonia and
- The Monetary Unit Act establishing the national currency, first in the form of a coupon, which, was replaced with the official currency, Macedonian denar, on 5 May 1993.

The diplomatic relations between the European Union and the Republic of Macedonia were established on 22 December 1995 when the EU opened the negotiations aimed to conclude the Agreement for cooperation in the field of trade, finance and transport. In the following year, the Republic of Macedonia signed the Agreement that made it eligible for assistance from the EU's Phare programme. The Cooperation Agreement as well as the Trade and Textile Agreements were signed in 1997 and entered into force in 1998. Following the conclusion of the negotiations in November 2000, the Stabilisation and Association Agreement was signed in Luxembourg on 9 April 2001, which came into force on 1 April 2004.

In February 2004, the Parliament of the Republic of Macedonia adopted a Declaration that underlined the accession to the European Union as the country's strategic goal and supported the intention of the Macedonian government to submit the application for EU membership, which happened on 22 March 2004. On 17 May 2004, the EU Council of Ministers decided to implement the procedure laid

down in Article 49 of the Treaty on the European Union. On 1 October 2004, the Republic of Macedonia received the Questionnaire from the EU Commission. The answers thereto were submitted to the Commission in February 2005. The opinion of the Commission (avis) is expected on 8 November and the status of the candidate country in December 2005.

After this general overview of the position of the Republic of Macedonia in the European integration process, I would like to address the legal aspects of the NBRM's independence according to the four-tier classification of the central bank independence defined by EMI: functional, institutional, personal and financial independence.

The legal bases for the NBRM are provided through the following regulations:

- The Constitution of the Republic of Macedonia adopted in 1991 and amended in 1992, 1998, 2001 and 2003, and
- The Law on the National Bank of the Republic of Macedonia (Law on the NBRM) adopted in 2002 and subsequently amended few times.

The general consideration is that the Law on the NBRM from 2002 is a big step toward the convergence of the NBRM legislation with that of the EU: Maastricht Treaty and the Protocol on the Statute of the ECSB and the ECB. In that regard, the Law on the NBRM establishes a relatively high degree of legal independence of the Macedonian Central Bank.

However, within the overall activities for revision of the regulations in the Republic of Macedonia on its way to EU integration, the Law on the NBRM has been also revised during the second half of 2004. That process highlighted particular areas in the Law that need to be adapted toward full compatibility with the provisions on independence of the national central banks in the Treaty (Article 108) and the Statute (Article 7 and 14.2). As a result, the NBRM launched activities for preparation of the new Law on the NBRM, fully compatible with the Treaty and the Statute. The new Law is expected to be passed by the Macedonian Parliament during the first half of 2006.

The present Law on the NBRM clearly defines the main target of the NBRM that prevails over all other objectives: price stability. Article 3 of the Law prescribes that: "The primary objective of the National Bank is to maintain price stability. The National Bank shall support the economic policy and financial stability without jeopardizing the fulfillment of the main objective, respecting the principles of market economy." This concept is based on Article 105(1) of the Treaty and Article 2 of the Statute that define the price stability as a primary objective of the ECSB.

However, having this in the Law on the NBRM can not be satisfactory without adequate provisions for institutional, personal and financial independence of the NBRM. This is due to the fact that the primary objective of price stability is the best served by a fully independent and accountable central bank with a precise definition of its mandate. The understanding for the need of the full legal

independence of the NBRM is growing in the Republic of Macedonia, not just because the academic literature which suggests that the independence of the central bank is crucial for the credibility of the monetary policy and worldwide trend of increasing central bank independence, but, also because the fact that the independence of the central bank is an element of the *acquis communautaire*.

Regarding the institutional independence of the NBRM, the present Law on the NBRM defines the NBRM as a fully state-owned legal entity. With that, the Law explicitly determines the legal personality of the Macedonian Central Bank as a separate institution from the other governmental institutions. Furthermore, Article 4 of the Law defines that “when exercising their functions, the NBRM and the members of its decision making bodies shall not seek or take instructions from the state institutions and bodies”.

However, according to Article 108 of the Treaty and Article 7 of the Statute, the draft Law on the NBRM enhances the definition of the institutional independence of the NBRM:

- ”When exercising their functions and tasks, the National Bank and the members of the decision-making bodies shall neither seek nor receive instructions from government bodies, government administration bodies, and other bodies and organizations.
- Government bodies, government administration bodies, and other bodies and organizations are obliged to adhere to the principle of paragraph 2 of this Article and not to influence the decision-making process of the National Bank and of the members of its decision-making bodies”

Going further in elaborating on legal aspects of institutional independence of the NBRM, it is worth to note that according to the present Law on the NBRM, the Macedonian Central Bank has sole authority to design and implement the monetary policy and the policy of exchange rate regime.

The revision of the present Law on the NBRM highlighted weaknesses that might jeopardize the institutional independence of the NBRM. Such an example is Article 67 which gives the Macedonian Parliament the possibility to make the final decision under the circumstances where the NBRM Council fails to make that decision and the Governor finds that not having such a decision might jeopardize the fulfillment of the main objective. In that case, the Governor makes a decision and submits the report to the Parliament, which makes the final decision on the next parliamentary session. Clearly, this provision from the present Law on NBRM put a significant risk for political influence in the decision making process of the NBRM and due to that has been excluded from the draft Law on NBRM.

Also, the draft Law on NBRM excludes the present Article 27 which stipulates the obligation for conclusion of the Agreement for managing and handling of the foreign exchange reserves, between the Governor of the NBRM and the Minister of Finance. Simply, such a provision can not be seen as a consistent with the defined institutional independence of the NBRM.

Speaking about institutional independence of central bank in terms of Maastricht criteria, there is a need to elaborate on central bank accountability as a counterweight of the independence. In that regard, the balance between institutional independence and accountability shall be defined through adequate provisions in the law, as both, independence and accountability are important features of a modern central bank, going toward the membership in the ESCB.

The present Law on the NBRM defines the lines of communication of the NBRM with the Macedonian Parliament, but it appears that some of the provisions go beyond the reasonable level of central bank accountability in the sense that they jeopardize the institutional independence. For example, Article 54 of the Law stipulates the obligation for the NBRM to submit the decision on monetary policy to the Parliament for the subsequent year and with that implies ex ante coordination of the monetary policy. Following the Maastricht Treaty requirements for central bank institutional independence, this provision shall be omitted in the new Law on the NBRM.

The draft Law on the NBRM prescribes the possibility for the Governor to be present at the meetings in the government and the Parliament and to express the opinion whenever the regulation that is linked with the position, tasks and duties of the NBRM is on the agenda. Also, it prescribes the possibility for the NBRM to propose to the Macedonian government the enactment of the laws that are related to the fulfillment of the main objective, functions and tasks of the NBRM.

Personal independence of the central bank shall be provided from two aspects:

- first, independence from political influence, provided through the procedures for appointment, term of office and dismissal of the members of the central bank governing bodies;
- second, independence from other sources of potential influences provided through the adequate provisions in the law that require minimum level of professionalism of the central bank top officials as well as incompatibility clauses aimed to avoid their potential conflict of interest.

According to the present Law on the NBRM, the governing bodies of the NBRM are:

- the Council of the NBRM consists of nine members, including the Governor and two Vice Governors, and
- the Governor;

The Law prescribes a 7-years term of office for the Governor, the three Vice Governors and the external members of the NBRM Council. This is in a compliance with Article 14.2 of the Statute which requires minimum 5-year term of office for the Governors of the national central banks. According to the EMI, this standard applies also to the members of the central bank decision making bodies.

The members of the NBRM Council, except the Governor and the Vice Governors, are not entitled to a renewal of mandate.

Speaking about personal independence of the NBRM from the legal point of view, serious weaknesses are determined in two segments: provisions for dismissal of the Governor, Vice Governors and external members of the NBRM Council and provisions aimed to prevent potential conflict of interests.

Namely, legal grounds for dismissal of the top NBRM officials are not compatible with article 14.2 of the Statute of ESCB and ECB, which defines that “Governor may be relieved from office only if he no longer fulfils the conditions required for the performance of his duties or if he has been guilty of serious misconduct.” This imposes a significant challenge for this issue to be adequately addressed in the new Law on the NBRM in order to prevent the Parliament from exercising its discretion to dismiss elected NBRM’s officials.

Although incompatibility clauses for the NBRM top officials are included in the present Law on the NBRM, they contain significant weaknesses and do not respect the generally shared view about personal integrity as a necessary qualification. According to Article 58 of the Law on the NBRM, persons convicted of crime and sentenced to imprisonment may become members of the NBRM governing bodies, after a certain period of time which depends on the length of the preceding imprisonment. This provision is excluded from the new Law on the NBRM.

The overall independence of the central bank can not be achieved without the ability to “avail itself autonomously of the appropriate economic means to fulfill its mandate”¹ Hence, financial independence is crucial in order to achieve the overall legal and actual independence of any central bank.

According to the Law on the NBRM, the Annual Budget of the NBRM shall be adopted by the NBRM Council. The Council adopts the annual financial statements of the NBRM that are part of the Annual Report of the NBRM. Annual financial statements are subject to independent audit.

The Law on the NBRM contains detailed provisions that regulate the allocation of the NBRM profit and the coverage of possible losses. However, there are weaknesses in these areas that should be addressed in the new Law on the NBRM:

- The proportions for allocation of the profit between the NBRM and the government have to be changed in order to safeguard appropriate means for the NBRM to be able to fulfill its tasks properly;
- The possibility, given in the present Law on the NBRM, for coverage of the possible loss through issuance of the government debt securities that shall be redeemed from the NBRM profit in the following years, must be avoided in the new Law on the NBRM. The reason for that is the potential hidden in this mechanism for coverage of NBRM losses, to involve a form of monetary financing because of the financial flow from the NBRM to the government in such a situation.

¹ European Monetary Institute Convergence Report (1996), p.102.

The Law on the NBRM prohibits direct financing of the government through overdrafts or any other credit facilities and direct acquisition of public debt instruments. Also, privileged access of the public sector to the NBRM funds is not allowed.

As a summary of this presentation, I would like to point out the following:

- a relatively high degree of legal independence of the NBRM has been achieved;
- however, significant weaknesses are identified in the present Law on the NBRM that require adjustment of number of provisions in order to achieve full compatibility with provisions on independence of national central banks according to the Maastricht criteria;
- the new Law on the NBRM is expected in 2006;
- the second step in the legal convergence– the legal integration of the NBRM into the euro system will follow – depending on the progress of integration of the Republic of Macedonia in the European Union.

Checks and Balances for the European Central Bank and the National Central Banks

Carel C. A. van den Berg

De Nederlandsche Bank

1. Introduction

The purpose of this lecture is to give an overview of how one could look at the relationship between the European Central Bank (ECB) and the eurosystem National Central Banks (NCBs) from the perspective of Checks and Balances. While a number of today's audience know the practice of this relationship, I will take a step back and look at this issue from the perspective of the legal document on which the European System of Central Banks (ESCB) is based: the Statute of the European System of Central Banks and of the European Central Bank (the 'Statute').

I will proceed by presenting first a model defining a system of Checks and Balances. This model will be applied to the ESCB Statute. A description will be given of the Federal Reserve System and the Bundesbank to allow for a comparison. The description of these two other central banks will focus on the role of the centre versus the periphery. We will focus on the weaknesses in the Statute seen from the perspective of Checks and Balances. After drawing some conclusions, we end with a description of possible future developments in the relationship between the ECB and the NCBs, including the effects of enlarging Monetary Union (and therefore the eurosystem) with new Member States.

2. Checks and Balances

Checks and Balances are a familiar term when describing federal *political* systems, but for instance the American central bank system (the Federal Reserve) and the ESCB are also a federal systems.¹ There is no universal short description of

¹ Warburg in his description of the difficult conception and first years of the Federal Reserve points out that 'the office (of the Reserve Board) was burdened with the handicap, commonly imposed upon so many branches of administration in a democracy, of a system of checks and counter-checks – a paralyzing system which gives powers with

‘federal’ or ‘federal system’. However, Elazar and Greilsammer (1986, p. 90) have given a useful description of ‘federalism’:

‘In strictly governmental terms, federalism is a form of political organization which unites separate polities within an overarching political system, enabling all to maintain their fundamental political integrity, and distributing power among general and constituent governments so that they all share in the system’s decision-making and executing processes. (F)ederalism has to do first and foremost with a relationship among entities – and then with the structure which embodies that relationship and provides the means for sustaining it.’

It is clear that the concept of federalism has to do with the *relationship* among entities and the structure which embodies it and sustains it. But still federalism is not the same as ‘checks and balances’. The best known example of a successful system of Checks and Balances is the United States Constitution (USC). The American political system is federal.² The essential feature is that the departments (branches) of government are not just separate from each other (i.e. having their own functional jurisdiction and the absence of personal unions),³ but also exert limited control over each other, to the extent necessary for preventing departments (branches) from assuming authority in areas for which other branches are responsible. This philosophy was based on the experience that especially the legislature if left to itself could expand its powers in the field of the executive and in extreme cases even taking on judicial powers. Such an extreme case had been the Long Parliament, which governed England for a period of twenty years (1640–1660) following the Civil War by appointing a host of committees dealing with all the affairs of state, confiscating property, summoning people before them, and dealing with them in a summary fashion. A similar, though less extreme development took place in the early years of the United States (1776–1787), when the States established constitutions based on the concept of the separation of powers, but where in fact the State legislatures soon meddled in every type of

one hand and takes them away with the other. (...)’ and ‘(...) many attempts were made to find a satisfactory answer to the tantalizing puzzle of how to safeguard the autonomy of the reserve banks while giving, at the same time, adequate coordinating and directing powers to the Reserve Board’ (Warburg, 1933, p. 166 and 170).

² Unlike many people think, there is no hierarchy between the States and the Federal Government, the only difference being that the power of the Federal Government extends to a larger area than that of an individual state. One has to be aware that the Thatcherite definition of federalism is a totally different case: for her federalism stood for all power going to the centre (the ‘federal’ government). Instead, the American (and German) concept of federalism has to do with the prevention of concentration of power.

³ This is the so-called concept of the separation of powers, which aims at preventing a too large concentration of governmental power in one hand. (See Zijlstra, 1996, chapter 5.3) One could say the motto of this concept is: ‘division of power by separation of functions’. The branches are the Executive, the Legislative and the Judicial branch.

government business, including those normally reserved to the judiciary. This explains why the Constitution of the United States of 1787 is based on a combination of the ideas of the separation of powers and checks and balances.⁴

Checks and balances presuppose one is able to distinguish several functional powers,⁵ which can be separated without creating deadlock. These checks can take different forms. Examples (taken from the American Constitution) are: the president has a veto power over Congressional legislation (though he can be overruled),⁶ Congress has the power of impeachment,⁷ the president nominates (e.g. Judges of the Supreme Court, Ambassadors, important officials) but needs the assent of the Senate,⁸ the Supreme Court may invalidate legislation.⁹ Some define the bicameral character of Congress, consisting of a House of Representatives and a Senate, as another (internal) check and balance, as both chambers have to agree with legislation.

Checks and balances can be framed with different time horizons. For instance, the examples of checks and balances in the American Constitution listed above can be divided into two groups: checks which work immediately (e.g. veto, assent) and checks which work over time (appointments). Checks that work over time probably

⁴ Vile (1967), p. 43, 143 and 145–147.

⁵ The most famous distinction is the ‘Trias Politica’, developed by Montesquieu (1689–1755). Montesquieu did not want to rely upon a concept of negative checks to the exercise of power, i.e. checks dependent upon the mere existence of potentially antagonistic agencies, charged with different functions of government – he went further, and advocated placing positive checks by placing powers of control over the other branches in the hands of each of them. In his writings the judiciary was not given powers of control over the other branches. At the same time, the judiciary’s independence in trying individual cases was to be absolute, i.e. not subject to control by the other branches, directly nor indirectly. (Vile, 1967, p. 87ff)

⁶ United States Constitution (USC), Art. I, section 7, paragraph 2. The president does not have a line item veto. A line item veto is considered unconstitutional by the Supreme Court (*Clinton v. City of New York*, 1998).

⁷ USC Art. I, section 2, par. 5; Art. I, section 3, par. 6 and 7; Art. II, section 4. The House impeaches, the Senate tries the impeachment. The impeachment procedure relates to the president, vice-president and all civil Officers of the United States, which includes federal judges (see Boon, 2001, p. 103–104). It is a typical feature of the American system that the president (Administration) cannot be dismissed by Congress (indeed, impeachment has not to do with policy, but with ‘treason, bribery or other high crimes and misdemeanours’); likewise the president cannot dissolve Congress and call for elections.

⁸ USC, Art. II, section 2, paragraph 2 (‘by and with the Advice and Consent of the Senate’).

⁹ The Supreme Court has the power to assess the constitutionality of State laws (USC Art. VI, section 2) and of Federal laws (*Marbury v. Madison*, 1803). This deviates from Montesquieu (see above). In other words, the Court sees itself as guardian of the system of checks and balances. It should be noted however that the Court does not have the means to enforce its opinion (see Boon, 2001, p. 118).

take away tensions which would otherwise be fought out in a different way, possibly leading to a break-up of the system. In other words, the presence of such checks and balances adds a desired flexibility to the system. It means the system or – within its mandate – a regulatory body can adjust its views over time to external circumstances, while at the same time it introduces certain continuity over the short run.

A definition of ‘*a system of checks and balances*’ which covers both external and (in case of a federally designed organization also) internal aspects could thus be formulated as follows: “a rule-governed system for two or more public bodies with rules which prevent the concentration of too much power in one public body (or a part of that public body), basically by separation of functions,¹⁰ but combined with rules which *protect* each public body’s power, which allow for *influence* by and over the other public bodies, which *stimulate co-operation* among these public bodies and which *prevent the dominance* of personal interest over public interest, among others through public control mechanisms.”¹¹

On top of this, these rules of the game should allow for some *intertemporal flexibility* (to prevent the need to overhaul the framework, which could put several valuable characteristics of the institution at risk). Intertemporal flexibility will serve the longevity of the system, because it allows for different degrees of power concentration, which could serve possible changing circumstances.¹² This element is especially relevant for the relation of the ESCB vis-à-vis the political authorities.

The above definition is unwieldy. In order to make it operational, the general definition can however be broken down in five sub-categories, all of which are important and should be present in a mature system checks and balances.

This leads to the following five categories of checks and balances:

- a. those which *protect* a body’s independence and competences;¹³

¹⁰ Usually a distinction is made between executive, legislative and judicial functions. A separate category are independent (regulatory) commissions/independent public agencies or organs established by or pursuant to public law and invested with any public authority. Such organs usually have a hybrid character (combining some regulatory and executive power). In these cases it is important to allow for enough distance between rule-making and the application of policy to individual cases.

¹¹ The checks and balances determine the rules of the game. These rules undoubtedly leave room for strategic behaviour of the parties involved. However, we do not look into this, as we look into the rules of the game themselves, which should ensure that powers do not become concentrated into the hands of one party.

¹² The importance of institutions being adaptable is also made by Douglass North, i.e. especially in complex environments characterized by non-efficient markets and incomplete information. Rigid institutional structures are not equated with success (North, 1994, p. 359–368).

¹³ This is a wide category covering inter alia the endowment of *exclusive* competences and mechanisms that shield from political pressure.

- b. *controlling* (or blocking) mechanisms (which give a branch the power to prevent the build-up of uncontrolled power by one of the other branches);¹⁴
- c. *consultation* mechanisms (either voluntary (i.e. at one's own initiative) or obligatory, i.e. when prior consultation is required);¹⁵
- d. *accountability* mechanisms;
- e. some degree of *flexibility* over time.

In a balanced system one would expect to find all categories of checks and balances to be reasonably represented.

3. Applying the Concept to the ESCB

3.1 Legal Description

The next step is to apply the concept of Checks and Balances to the ESCB. In fact, it can be applied at two levels:

1. The *external* level, which covers the relation between the ESCB and the political authorities.¹⁶
2. The *internal* level, which relates to the ECB and NCBS.

The internal level can be divided into two sets of relationships:

- a. One set covering the relationship between the NCB Governors and the Executive Board. This relates to the decision-making process and checks and balances within the Governing Council, and in other words to the voting system.
- b. Another set covering the relations between the ECB and the NCBS. This pertains to the division of labour between the centre and the regional central banks – the topic of this paper.

As a next step, all articles which describe operational powers have been identified. There are twenty-two articles of the Statute which define operational (non-decision-making) powers of the ECB and/or NCBS. These are: Art. 5, 6, 9.2,

¹⁴ Examples are the right of the U.S. president to veto budget proposals by Congress and the requirement of Senate consent for the presidential appointment of new members of, for example, the Supreme Court and the Board of Governors. Such mechanisms ensure that no power can fulfil its tasks in an efficient way without at least the assistance of one of the other powers, thus controlling the use which the first power makes of its authority (Lenaerts, 1991, p. 11).

¹⁵ A difference between consultation and accountability is that consultation takes place *ex ante* and accountability *ex post*.

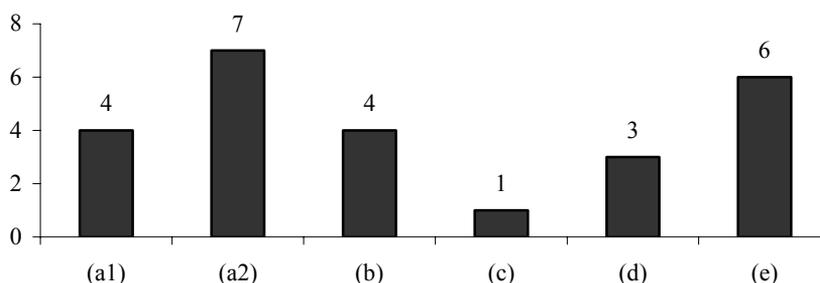
¹⁶ The external relation is usually described in terms of independence and accountability. However, the concept of Checks and Balances is wider, because it also looks at interdependencies and cooperation mechanisms.

12.1c, 12.3, 14.3, 14.4, 16, 17, 18, 19, 21, 22, 23, 24, 25.2, 26, 30.1, 30.5, 31, 32, 33.

These articles are then divided over the five categories of checks and balances, i.e. each article is allocated to at least one of these categories. This gives the following the result:

Chart 1: Internal Checks and Balances – ECB versus NCBS

Number of checks and balances per category



Legend: (a1) Checks and balances protecting the prerogatives of the ECB
 (a2) Checks and balances protecting the prerogatives of the NCBS
 (b) Controlling (or blocking) mechanisms
 (c) Consultation mechanisms
 (d) Accountability mechanisms
 (e) Checks and balances allowing for flexibility over time

Note: Some articles are relevant for more than one category, while Art. 17–24 have been counted as one article because these articles all represent open market and other monetary instruments.

Source: Van den Berg (2005).

Some examples might help to explain chart 1: (a1) contains inter alia the article according to which the ECB has the exclusive task to see to it that the System performs its tasks (Art. 9.2); (a2) Art. 5.2 and 12.1c introduce a decentralization preference – but not an absolute one; (b) contains i.a. the right of the ECB to impose restrictions on NCBS' behaviour; (c) the most important consultation mechanism (and only one) is through the ESCB committees, established under art. 12.3 (Rules of Procedure); (d) refers to information requirements; (e) contains articles allowing monetary operations to be conducted by *both* ECB and NCBS. A full description is given in *Appendix 1*.

The main result of this exercise, though it is simplified because of un-weighted totals, seems to be an unusual high score for the category of checks and balances relating to flexibility (e).

3.2 Federal Reserve¹⁷ and Bundesbank

To get an impression of how unique (or not) this high degree of flexibility in the area of operational functions is, we describe shortly the American and German central bank systems.

All *operational* powers of the *Federal Reserve*, established by the Federal Reserve Act (FRA) of 1913, are vested in the twelve Federal Reserve Banks (FRBs). Each of them operates a discount window, they have functions in the area of cash and payment systems, they hold assets, they supervise state member banks and foreign banks (the latter a delegated function by the Board) and are allowed to conduct open market operations (OMOs), which initially were not seen as monetary policy instruments, but as possibilities to generate income, e.g., in periods when discount loans were low. Over the years the FRBs recognized the monetary impact of the OMOs and they started to coordinate their open market operations. The OMOs became concentrated in New York, where they were conducted by the Federal Reserve Bank of New York, also on behalf of a number of other FRBs, because the market of government securities was by far deepest in New York. This explains why the Federal Open Market Committee (established in 1933), which each year elects the manager of its OMOs, always elects the New York Fed as the manager of the System Open Market Account. The FRBs are privately owned (the member banks being the shareholders). The Board of Governors (initially called Federal Reserve Board) has no monetary assets and no operational competences. It decides on regulations (e.g. collateral, supervisory policy), approves discount changes proposed by FRBs, sets reserve requirements within limits (since 1935 without Presidential approval), approves the appointment of the FRB presidents (1935), oversees the FRBs' activities and controls their budgets, controls the international representation (1933), forms a majority in FOMC (1935) (before 1933 OMOs were coordinated voluntarily).

At this place we already note that the Board of Governors of the FRS has more own powers than the ECB's Executive Board – see also *Appendix 2*.

An interesting aspect of the Bundesbank is in fact that its direct predecessor (and therefore also to a considerable degree itself) is of American design.¹⁸ In 1948

¹⁷ The word *System* (FRS) was introduced in the FRA only in 1935, when the Federal Reserve Board was renamed the 'Board of Governors of the Federal Reserve System' (FRA Section 10) and the Board members became member of the FOMC. The FRA of 1913 only mentioned the establishment of the FRBs and the Board, and their respective powers.

the Bank deutscher Länder (BdL) had been established as a *federal* central bank system, because the Americans, who dominated the Allied Bank Commission, wanted to prevent the re-creation of a unitary central bank, like the Reichsbank, which could more easily be misused by a nationalistic government. The board of the BdL was also a regulatory agency (like the Board of Governors) without operational functions, which functions belonged to the regional central banks. The Americans also introduced a minimum reserve system. In 1957 the Bundesbank became the successor of the BdL. After intense debate in the German government and parliament,¹⁹ it was decided that the Landeszentralbanken would become branches of the Bundesbank, but would retain their seat (and vote) in the Zentralbankrat. The Head Office (in Frankfurt) received operational capacities. It would conduct all open market operations, all foreign exchange transactions and transactions with foreign countries, credit operations with federally relevant banks and would be fiscal agent for the Federal Government. The (initially eleven) Landeszentralbanken could perform transactions with local governments and local banks – under instruction from the centre.

These examples show that several models are possible. However, an important aspect of the American and German models is that in terms of division of labour their models are *stable*, while the ESCB Statute is relatively open-ended. This leads to the question, why the ESCB Statute is as open-ended as it is. To answer that question we turn to the *genesis* of the Statute of the European System of Central Banks and of the European Central Bank. For this purpose we go back to the time the Statute was drafted.

3.3 Genesis of the Wording of the Statute²⁰

The Statute of the ESCB and of the ECB was drafted by the Committee of Governors (CoG) of the Central Banks of the Member States of the European Community (EC) in the period May – November 1990. They proposed drafting it once the Heads of State had decided to start an Intergovernmental Conference (IGC) on Economic and Monetary Union at the latest at the end of 1990. The CoG then consisted of twelve governors, among them the governor of the Bank of England. They based themselves on the Delors Report on Economic and Monetary Union in the EC (April 1989), written by a committee in which all of them had participated as well. The Delors Report, however, was short on the design of the System, except that it would have a federal character, i.e. the NCBs would continue to exist, a federal ESCB Council would decide on the main policy issues and a

¹⁸ Von Bonin (1979), p. 81.

¹⁹ See also von Bonin (1979), p. 79–82 and Buchheim (1999), p. 67 and 73.

²⁰ Based on van den Berg (2005).

central institution could be established (with its own balance sheet). In the Delors Report the tasks of the System were ascribed to the System.

In the Committee of Governors three issues stood out as being difficult to agree upon: (1) the division of tasks between the ECB and the NCBS, (2) the division of tasks between the governors and the Executive Board, and (3) the relation between the ECB and the other Community institutions. As regards the division of labour two opposed views within the CoG became apparent: the Bundesbank versus the Banque de France. Bundesbank president Pöhl favored a *strong federal centre* which should be more than a token institution, inter alia because such a strong centre would better be able to withstand political pressures. On the other hand, the governor of the Banque de France, de Larosière, referred to the principle of subsidiarity (in fact meaning: decentralization). He was supported by basically all other governors.²¹ Given these opposing views, the Secretariat of the CoG tried to accommodate both sides: it drafted a text according to which the ECB would be endowed with operational competences, but operations would *normally* be executed by NCBS.

The discussion subsequently focused on *who* should decide the degree of decentralization. The debate heated when it was decided for legal reasons to substitute the words ESCB/System for 'ECB and NCBS' in all cases of operational tasks, because the System did not have legal personality. (Another argument used in favour of mentioning the ECB in these operational articles was that in this way one would avoid having to go the Council of Ministers for approval of an amendment of a part of the Statute, in case one wanted to give the ECB operational competences it did not have according to the Statute.) Tietmeyer (deputy governor of the Bundesbank) wanted the centre to decide on the degree of centralization. This led to a stalemate and the IGC was given two alternative options. The IGC would decide not to follow the German position. It left it to the ECB (read: GovC) instead of to the Executive Board of the ECB to decide on the degree of decentralization, with Article 12.3, third paragraph²² reading:

'To the extent deemed possible and appropriate and without prejudice to the provisions of this Article, the ECB shall have recourse to the NCBS to carry out operations which form part of the tasks of the ESCB.'

Relevant here is that in another article the ECB has been given the task to ensure that the decisions of the GovC are implemented (Art. 9.2).

Noteworthy is also that the IGC in its search for a compromise text had left out the word 'full' in 'full extent possible' in the non-German alternative.

²¹ In line with these conflicting views, no one but the Bundesbank wanted to give the Executive Board independent (i.e. not only delegated) policy-making or regulatory tasks. Bundesbank lost in the CoG, but won in the IGC though the Executive Board's powers are encapsulated in a framework set and defined by the GovC under Art. 12.1 (first paragraph).

²² At other places denoted as 'Art. 12.1c'.

The fact that Article 12.1c introduces a bias towards recourse to the NCBs does not take away that there is hardly any operational task of the System *exclusively* reserved for the NCBs. One of the persons involved in writing the Statute for the CoG later said that changing ‘ESCB’ into ‘ECB and NCBs’ was a *coupe* in favour of the future ECB, as it opened all kinds of possibilities for the centre, including in theory full centralization.²³

3.4 Criticism

Art. 12.1c in combination with the other articles would seem to be too open-ended. It allows ‘winner takes all’. Although for all practical reasons only a remote possibility, it still is a possibility and this is not productive, because it could make NCBs suspicious of the intentions of the ECB (Executive Board) and uncertain about the final division of labour. This is not optimal for the cooperative attitude within the System. If the Board were ever to dominate the GovC (in terms of members or votes), like happened in the FOMC in the United States, the risk is that the NCBs would lose gradually their operational activities, because the Board could interpret Art. 12.1c (and especially the clause ‘where appropriate’) in a different way than a GovC dominated by governors. There is also a link between the division of labour and the System’s independence. If NCBs would lose their operational tasks, the role of the national governors in the GovC would diminish and their participation could be at risk in the long run, in which case the System’s independence would weaken, because a smaller less diverse committee would succumb more easily to external pressure. In the European context the case for a strongly independent ESCB is stronger than at the national level where better mechanisms exist to prevent abuse by the Executive.

In sum, there are checks and balances between the ECB and the NCBs (see chart 1). At present the balance is in favour of the NCBs (see below), but this balance is in the hands of the GovC, and not in the hands of a legal document as immutable as a Statute. Indeed, based on the ESCB Statute the position of the NCBs as operational eurosysteem entities is weaker than the position of the Federal Reserve Banks and even than that of the Landeszentralbanken under pre-EMU Bundesbank.²⁴ The division of labour seems to be too open-ended: the Statute

²³ One additional observation is that Art. 12.1c refers explicitly to ‘recourse to the NCBs’ (and not ‘recourse to NCBs’). During the IGC Spain made explicit it supported these texts only because ‘the’ referred to “*all*” NCBs (and not to a few NCBs). This means the GovC cannot impose specialization without every NCB agreeing.

²⁴ We abstract from changes in the Statute itself, which is always possible. Vide for instance the change in the Bundesbank structure following its accession to the eurosysteem. The Bundesbank president is an independent member of the GovC à titre personnel and could not be bound anymore by the Zentralbankrat (ZBR). The reduced

could and should have provided for, e.g., standing facilities and payment accounts to be attached *exclusively* to NCBS (leaving open possible specialization among them), while for instance the ECB should unequivocally have been allowed to manage the pooled foreign reserves by itself (naturally within the restrictions set by the GovC) without using – as is presently the case – the NCBS as agents. In the early years this may have made sense, because the ECB has been enjoying full immunity status in the U.S. as an international organization only since May 2003.²⁵

Below we will describe the actual division of labour and then discuss several possible future scenarios.

4. Present Situation and Future Developments

4.1 Present Division of Labour

The present division is based on the so-called *General Documentation*, which describes the procedures within the eurosystem and which is approved by the GovC. In the General Documentation one finds a strong emphasis on decentralization. Most operational tasks fall onto the NCBS. By contrast, the ECB only deals directly with market participants in case of foreign exchange interventions; furthermore it has a high profile in international meetings; it provides payment services to a few international organisations; it is involved in payment systems oversight; it is allowed to perform bilateral open market operations in specific exceptional circumstances (which until now never occurred). The question could be raised already now: is the present division of labour (i) effective and (ii) stable?

4.2 Future Developments

(i) In general, one should say that the present division of labour is effective, as the ESCB has been able to implement its monetary policy in a smooth and effective way – even though gradual improvements are possible and are also continuously being made. (ii) Another question is whether there are factors which could lead to a shift of operational tasks to the ECB. We will deal with possible future developments, which might affect the current division of labour.

1. Are there not efficiency reasons to centralize Open Market Operations (the weekly tenders) in an NCB or the ECB? The answer is no, because Information

role of the ZBR led to an overhaul of the Bundesbank structure: the LZB presidents lost their seat and vote in the ZBR.

²⁵ At present the interpretation of the Statute is that even Art. 30.1 falls under the decentralization principle (Art. 12.1, third paragraph), because the pooled reserves can be considered as a policy ‘instrument’ (intervention policy).

and Communication Technology (ICT) has made same-time operations at different locations possible.²⁶ Also, there still exist local legal differences, making local approaches more apt, but even harmonization of systems and national idiosyncrasies would not make centralization or specialization necessary or desirable. Many small banks would like to retain direct local access to their NCB. Also, local contacts support supervisory effectiveness and efficiency by local NCBs with supervisory functions.

2. What were to happen if the UK joined and major banks relocated their front and/or head offices to London? In that case volume might move to London, but not all OMOs. Will that not lead to a primary dealer system? No, not necessarily, because repurchase operations by the eurosystem would remain directly open to each monetary financial institution.
3. The ECB (Executive Board) could try to centralize the international representation more and more. In fact, this is already happening. However, there are limits to this, because NCBs have non-System functions, which give them a reason to stay active internationally. Nonetheless, a logical area for further consideration.
4. Some *informal* specialization could take place, with some NCBs gradually specializing, e.g., in certain areas of statistical expertise or research (organic model). This would require support from the ECB, which again stresses the importance of cooperative attitudes.
5. Will this process change with *enlargement*? I see four possible developments with enlargement of the euro area:
 - a. Enlargement of the euro area could very well lead to more *specialization*, in a *voluntary* fashion. But most likely ECB support is needed for this to happen, because central banks might be reluctant to give other NCBs specific tasks.
 - b. After enlargement of the euro area I see an increased role for ESCB Committees, but they should be smaller structured and probably meet less frequently. Smaller sized committees would lend themselves better for chairmanships by NCBs. At present most committees are chaired by a person from the ECB, which in a number of cases is seen by the NCBs as a way by the ECB to orchestrate and regulate too much.
 - c. Because of the diversity of membership and the number of member central banks, an increased role for Executive Board in international representation would seem natural and inevitable.

²⁶ The NCBs collect the bids of their banks to the tender, send them to the ECB (Frankfurt), which takes the allotment decision (percentage) and announces the allotment result, staying within the decisions of the GovC.

- d. The importance of non-System tasks for NCBS will not diminish, but *increase*, if only in order to stay an attractive employer.

The biggest potential threat for NCBS arising from enlargement (a reduced Governing Council with a majority for the Executive Board) did not materialize, but this option is never completely from the table.

5. Conclusion

The objective of the presented paper is to develop a view on the relative roles of the ECB on the one hand and of the NCBS on the other hand as operational entities of the ESCB. We did not base this on the actual division of labour, which can evolve over time, but on the roles and competences as described in the legal document on which the ESCB is based, i.e. the Statute of the European System of Central Banks and of the European Central Bank. In order to be able to evaluate the relationship between the ECB and the NCBS as operational entities within the ESCB and detect possible inherent tensions between them, we looked at their roles from the perspective of checks and balances. We found evidence of a too open-ended division of labour, which became even more evident when compared to the legal situation in the Federal Reserve System and the pre-EMU Bundesbank. The direction of the future development lies in the hands of the Governing Council and its voting rules, which is subject to change and with it possibly the interpretation of the non-absolute decentralization bias.

Though no changes are expected or needed for the near future, the long-term outcome is uncertain. While flexibility in the relative operational roles in itself is desirable, the degree of flexibility contained in the Statute is unnecessarily large, creating unnecessary uncertainty and possible tensions among the components of the ESCB.

References

- Van den Berg, C. C. A. (2005), *The Making of the Statute of the European System of Central Banks – An Application of Checks and Balances*.
- Von Bonin, K. (1979), *Zentralbanken zwischen funktioneller Unabhängigkeit und Politischer Autonomie*.
- Boon, P. J. (2001), *Amerikaans staatsrecht*.
- Buchheim, C. (1999), *The Establishment of the Bank deutscher Länder and the West German Currency Reform*, in: *Deutsche Bundesbank (1999), Fifty Years of the Deutsche Mark*, pp. 55–102.
- Delors Committee (Committee for the Study of Economic and Monetary Union) (1989), *Report on Economic and Monetary Union in the European Community (Delors Report)*, Office for Official Publications of the European Communities.

- Elazar, D. J. and Greilsammer, I (1986), *Federal Democracy: The U.S.A. and Europe Compared – A Political Science Perspective*, in: Cappelletti et al. ed., *Integration Through Law*, Volume 1.
- European Central Bank (1998), *The Single Monetary Policy in Stage Three, General Documentation on ESCB Monetary Policy Instruments and Procedures (General Documentation)*, first published in September 1998 and regularly updated.
- Lenaerts, K. (1991), *Some Reflections on the Separation of Powers in the European Community*, CML Review 11.
- North, D. (1994), *Economic Performance Through Time*, *American Economic Review* Volume 84, Issue 3, p. 359–368.)
- Vile, M. C. J. (1967), *Constitutionalism and the Separation of Powers*.
- Warburg, P. M. (1930), *The Federal Reserve System, Its Origins and Growth*.
- Zijlstra, S. E. (1996), *Zelfstandige Bestuursorganen in een Democratische Rechtsstaat*.

List with Abbreviations

BdL	Bank deutscher Länder
CoG	Committee of Governors of the Central Banks of the EC Member States
EC	European Community
ECB	European Central Bank
ESCB	European System of Central Banks
FOMC	Federal Open Market Committee
FRA	Federal Reserve Act
FRB	Federal Reserve Bank
FRS	Federal Reserve System
GD	General Documentation on ESCB Monetary Policy Instruments and Procedures
GovC	Governing Council of the E(S)CB
IGC	Intergovernmental Conference
LZB	Landeszentralbank
NCB	National Central Bank
OMOs	Open Market Operations
RoP	Rules of Procedure
USC	United States Constitution
ZBR	Zentralbankrat

Appendix 1: Allocation of the Operational Articles over Five Categories of Checks and Balances (C&Bs)

(Numbers refer to articles of the ESCB Statute)

- (a1) covers the C&Bs that protect the prerogatives of the *ECB*: the ECB has the task to see to it that the System performs its tasks (9.2) and has the full right to hold and manage the pooled foreign reserves (30.1) and IMF reserve tranche positions (30.5); it has the right to accept invitations to participate in (the capital of) international monetary institutions (6).
- (a2) covers the C&Bs that protect the prerogatives of *NCBs*: 5.2 (collection of statistics) and 12.1c (monetary instruments) contain the decentralization *preference* (i.e. no hard protection); 14.4 safeguards the right of NCBs to perform non-System tasks; 31, 32, 33 protect the NCBs' financial rights (3.3 protects the NCBs as it limits the ECB's supervisory powers).
- (b) covers blocking mechanisms: the ECB may *impose restrictions* on the behaviour of NCBs (6, 14.3, 14.4 and 31), though in these cases the GovC has to approve. There are no mechanisms for NCBs to *block* the ECB from undertaking certain actions.
- (c) The Statute does not provide directly for *consultation* mechanisms, but the Rules Procedure (based on 12.3) do (through the establishment of ESCB committees in art. 9-RoP).
- (d) *Accountability* mechanisms are contained in 14.3 (information duty of NCBs) and 26 (ECB reporting). Art. 12.3 (RoP) can also be used for this purpose.
- (e): *flexibility* category: all operational tasks can be performed by *both* the ECB and the NCBs (16, 17–24). Flexibility (with respect to the ECB) is also contained in 25.2 (prudential supervision), 6 (external representation) and 5.2 (collection of statistics).

Appendix 2: Some Facts about the Federal Reserve System

- Main feature of the Federal Reserve Act (1913) was to provide for the establishment of *Federal Reserve Banks* (and to furnish an elastic currency through discounting commercial bills and to establish better supervision). Federal Reserve Banks hold assets and conduct all operations (and not the Board). Each FRB has legal personality. Specialization developed later (not in FRA).
- *Board of Governors* has no operational powers, but has a strong grip on FRBs (oversight). Also through its independent decision-making in certain areas and its majority in the FOMC, the Board of Governors of the FRS seems stronger than the ECB's Executive Board.

- *FRBs* do not have non-system functions (eurosystem NCBS do).
- The *Board of Governors* approves the FRB's budgets. In contrast, in Europe the GovC approves the ECB's budget. The ESCB's NCBS own the shares of the ECB.

A National Central Bank within a Federal System¹

*Philippe Bonzom
Christian Barontini
Banque de France*

“Sovereignty withers when it is imprisoned in its structures of the past. In order for it to live on, it must be transferred, as the scope of activity expands in a greater space. It can then unite with other sovereignties that are evolving in the same direction. None of them are lost in this transfer; rather, all are strengthened.”

Jean Monnet

In his *Mémoires*, published in 1976, Jean Monnet, one of Europe’s “fathers”, had this luminous explanation of the *raison d’être* and of the modalities of regional integration in general, and of the *de facto* federal construction of Europe in particular. His statement applied primarily to the sovereignty of the national State, faced with all sorts of economic, social and political effects/externalities of globalization. But it can also be applied to monetary policy and central banks, especially when the scope of financial activity (capital movements) expands to a greater, regional area. In Europe, national central banks (NCBs) of the euro area have thus been led to unite. Together with the ECB, they form the Eurosystem, to which one can apply many of the ideas associated, in political sciences and philosophy, with the concept of “federalism”. Indeed, the ECB/Eurosystem is one of the four federal institutions of the European Union.² What is more, the ECB/Eurosystem is built according to a federal framework, with a centre (the ECB) and 12 other member institutions (the NCBs).

¹ The views expressed in this article are those of the authors and do not necessarily represent the positions of the Banque de France. The authors would like to thank their Banque de France colleagues, in particular, Emmanuelle Politronacci and Cécilia Lemonnier for their contribution on linguistic issues, and Anne-Marie Moulin and Romain Bardy on legal aspects.

² Together with the European Parliament, the Court of Justice and the Commission.

Hence, it is no wonder that the traditional debates about federalism have touched upon the Eurosystem. On the one hand, the jury is out, in academic circles, about the optimal level of centralization or decentralization or about the relevance or irrelevance of an *à la FED* evolution (whatever that means exactly). On the other hand, the Eurosystem emphasizes its team spirit and the good functioning of its decentralized set-up.

This debate needs not be over-dramatized. First, because social sciences point to the unavoidable (and potentially creative) “tension” between a centre and its periphery in any federal – indeed, in any human – organization. Second, because the Eurosystem seems to have found an apparent (even though certainly dynamic) equilibrium. To illustrate these ideas, we would like to point to the various reasons for the decentralized set-up of the Eurosystem (1) and to the working of this decentralized set-up, especially at the NCB level (2).

1. Reasons for the Decentralized Set-Up

We have selected six main reasons that played a key role in the choice of a decentralized set-up.

1.1 Compliance with the Treaty and the Statutes

The official acronym of the system is “ESCB” which stands for “European System of Central Banks”³. The choice of the plural form for “Central Banks” was a very conscious one. The Treaty drafters wanted to take into account, inter alia, the historical background rooted in institutions bearing the very names of the various countries of the European Union (Oesterreichische Nationalbank, Deutsche Bundesbank, Banque Nationale de Belgique, Banque de France...). Before them, the Delors Report had explicitly proposed “a federative statute, since this would correspond best to the political diversity of the Community”⁴.

A second, somewhat related aspect stemming from the Treaty is the status of the Governing Council as the supreme decision-making body of the ECB/Eurosystem: this is the body in which all euro area NCBs Governors participate. They do not represent their NCB; rather, they sit on the Council in their personal capacity (very much like the Board members, for that matter, who do not

³ The ESCB gathers all EU central banks. The term “Eurosystem” has been chosen to identify specifically the grouping of the central banks of the euro area.

⁴ The Werner Report (1970) was less explicit than the Delors Report in its description of the future institutional set-up for EMU in general and monetary policy in particular. In this later regard, it just mentioned the need for a central body “comparable to the U.S. Federal Reserve Board.”

represent the ECB in the Council). But, part of their personal capacity certainly derives from them running (and having been chosen to run) an NCB.

Finally, and quite consistently with the above, Article 12.1 of the Statute provides that “to the extent deemed possible and appropriate (...), the ECB shall have recourse to the national central banks to carry out operations which form part of the tasks of the ESCB.” In the same vein, most provisions of the Statute dealing with the various specific functions of the monetary authorities allocate them either to the ESCB/Eurosystem or to “the ECB and the NCBs”.

There is thus, both in the words of the Treaty and in the spirit in which it was drafted, a solid foundation for a decentralized set-up.

1.2 NCB’s Experience as an Asset for the System

The choice of this kind of decentralized set-up also underlines the wish to make the system benefit from the NCBs’ experience and credibility.

The fact that the NCBs’ historical legitimacy has been brought as an asset to the system was clearly illustrated by the evolution of market interest rates in the transition to EMU: they converged not towards the average level of participating currencies but towards the lowest level, achieved by the most credible participating NCBs. In this sense, there is hardly any factual basis for the argument that the ECB would be a “young institution”, “lacking credibility and track record” (some of the worst – but, in this case, unfounded – accusations one can make to a central bank!).

On a more operational basis, it is clear that each NCB brings to the Eurosystem its long standing expertise and knowledge of its national economy, its national financial system, its national political framework, its national currency distribution networks, etc... NCBs are well placed, geographically, to have direct access to and contact with economic agents (including public authorities, banks, companies, consumers/citizens). They bring this expertise to the Eurosystem’s collective analysis and, hopefully, collective wisdom.

1.3 Level Playing Field between National Financial Centers

A key, operational feature of the Eurosystem is that NCBs keep the accounts of commercial banks on their books (see art. 2.1 of the General documentation on Eurosystem monetary policy and instruments, last amended in February 2005).⁵

This feature is not that original since, for instance, within the U.S. Federal Reserve System, the Board in Washington D.C. does not keep commercial banks

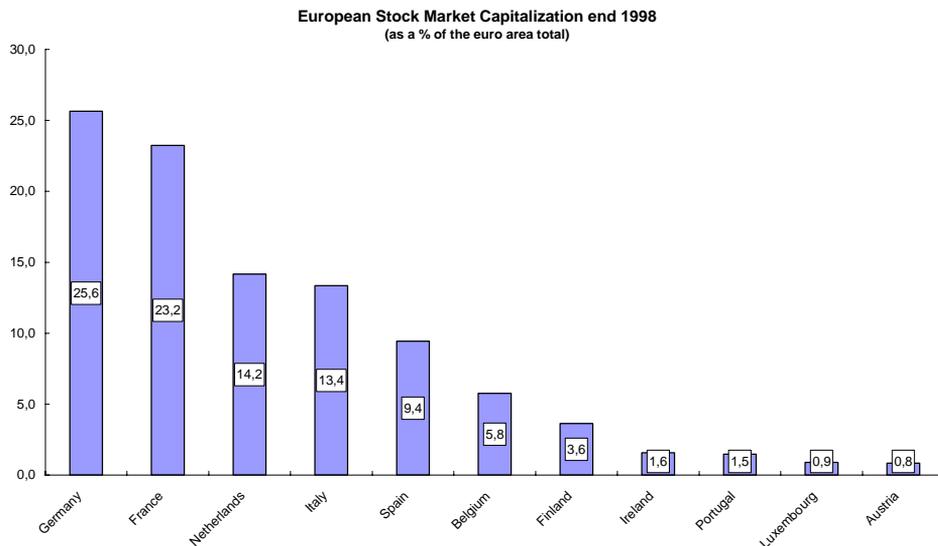
5 “An institution may access the Eurosystem’s standing facilities and open market operations based on standardtenders only through the national central bank of the Member State in which it is established.”

accounts on its books. However, in the European context, this feature has special significance, linked to the structure of European financial markets.

Indeed, if a centralized set-up had been chosen for monetary policy, commercial banks might have been tempted to concentrate some of their key management activities (at least liquidity management) where their central banking counterpart was located. This would have been tantamount to taking an “administrative/political” decision interfering with the normal competition between financial centres.

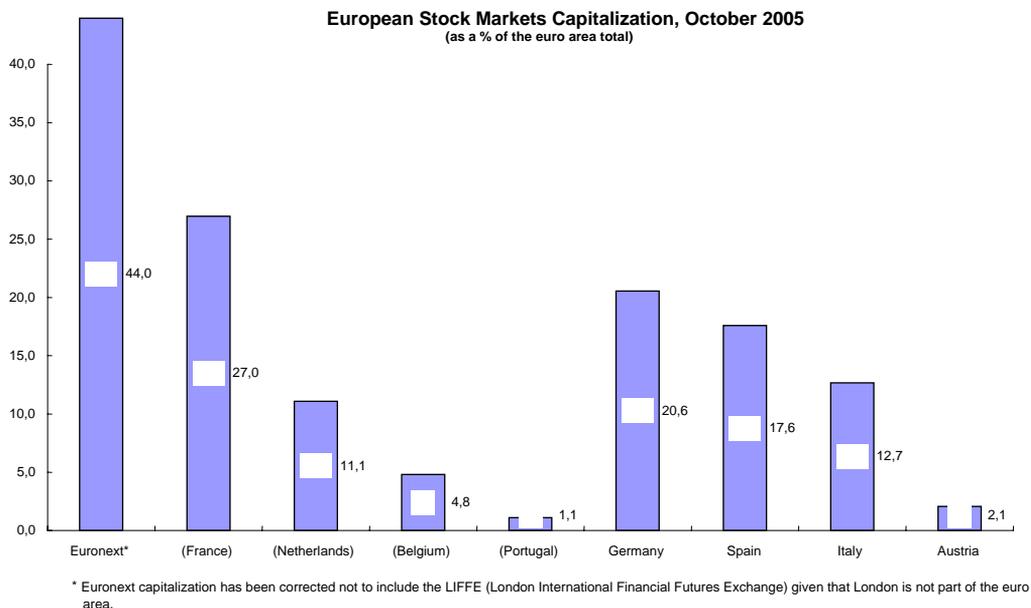
The structure of European financial markets is, in this regard, quite decentralized: this was the case in 1998, when the decision on the organization of the Eurosystem was taken (chart 1); this is still the case, seven years later, even after a degree of consolidation has taken place, with the creation of Euronext (chart 2). This situation is radically different from the one prevailing in the U.S.A. where (1) the Board has its headquarters in a town which is not a financial centre and (2) one financial centre (New York City) overwhelmingly dominates all the others. In the U.S.A., the conduct of monetary operations is delegated to one single member of the U.S. central banking system, namely the Federal Reserve Bank of New York.

Chart 1: Decentralized Structure of the Euro Area Financial Centres in 1998



Source: World-Federation of Exchange, Banque de France calculations.

Chart 2: Decentralized Structure of the Euro Area Financial Centres in 2005



Source: World Federation of Exchange Members, Banque de France calculations.

It may well be that, over time, the competition between the European financial centres will lead to a higher degree of concentration between them. But, especially in a market economy, one may argue that “administrative/political” decisions on the central bank’s organization should not be a determinant of this phenomenon.⁶

1.4 Multilingual Communication

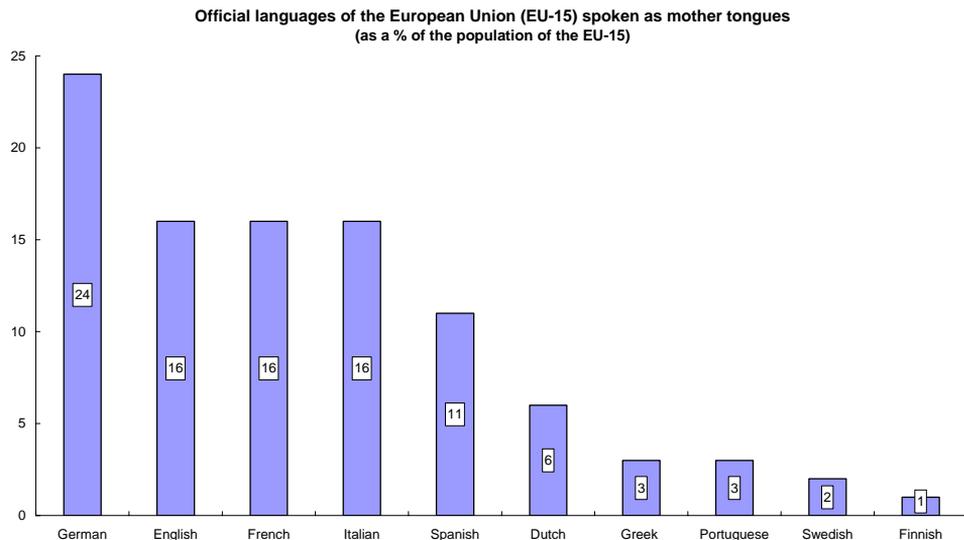
Another, perhaps even more striking difference between the working environments of the ECB/Eurosystem and of the U.S. Federal Reserve System relates to the issue of languages. From a legal and institutional point of view, the EU has 25 Member States and 20 official and working languages (“official and working languages of the institutions of the EU”, as established in Regulation No. 1 of 1958, which has been adapted after each enlargement).⁷ The euro area has 10 of these 20 languages.

⁶ It might be worth recalling, in this respect, that the Statute provides that “the ESCB shall act in accordance with the principle of an open market economy with free competition”.

⁷ As from January 2007, Irish is to become the 21st official language.

From a practical point of view also, no European language is spoken as mother tongue by more than 25% of the EU 15 population (German 24%, French, English and Italian 16% each) and no European language is understood by more than half of the EU 15 population (chart 3). By contrast, in the U.S.A., more than 90% of the population has the same language as its mother tongue or speaks it very well (Census 2000).

Chart 3: Linguistic Diversity in Europe



Source: Eurobarometer 54 Special, Europeans & languages, February 2001.

“Central bankese” is already a rather difficult idiom, in any language. If monetary policy messages cannot be communicated to economic agents/citizens in their own language, the efficiency of monetary policy is at risk. Tougher measures would be needed, to get the same result. The presence of the NCBs and their experience in communicating on monetary policy in their fellow-citizens’ own language, taking into account their constantly evolving cultural patterns, are thus key assets for the central banking system of a multilingual polity like the euro area.

1.5 Independence

It has been argued (Goodfriend, 2000) that the more decentralized a system, the more independent it can be. This may stem from the fact that a decentralized

system is less prone to bend to external pressure.⁸ And, indeed, decision-makers in a decentralized system derive their legitimacy from a variety of backgrounds.

It is thus useful, in order to have an independent monetary policy, to have some members of the ECB Governing Council nominated by European institutions and others by national institutions. Since independence must go hand in hand with accountability, this is reflected in the fact that the ECB is accountable, *inter alia*, to the European Parliament while most NCB Governors are accountable, *inter alia*, to their national parliament.

1.6 Possibilities Offered by New Technologies

Finally, one should stress that the Eurosystem's organizational framework was decided in a context characterized by the advances in new technologies: e-mail, teleconference, visioconference, electronic payment. Having benefited from this progress since its creation, the Eurosystem team, even though geographically spread out over a continent, can fully ensure real-time circulation of information, real-time decision-making and real-time implementation of decisions (including real-time transfers of funds). This was illustrated, for instance, in the immediate aftermath of the September 11, 2001 tragic events. And this is another radical difference with the historical and technological context in which other federal central banking systems were built and first operated.

Conversely, the fact that the implementation of decisions is not geographically concentrated may even help meet the challenges raised by the continuity of operations in times of crises.

2. Working of the Decentralized Set-Up

On this point also, we would like to select a few key areas of the functioning of a central banking system and look at how it works in the case of the Eurosystem.

2.1 Conduct of Monetary Policy

In the early U.S. Fed, Federal Reserve Banks were allowed to implement monetary policy decisions with a relatively high degree of discretion. This contributed to a non optimal monetary strategy which even had some bearing on the making of the 1929 Crisis (Meltzer, 2002). In the Eurosystem's case, everything was designed,

⁸ As the Federal Reserve System puts it, "Congress has carefully insulated the Federal Reserve from day-to-day political pressures so it may act in the best interests of the country. (By devising a system with a Board and 12 District Banks,) Congress wisely spread the policymaking machinery throughout the System (...)", Federal Reserve Bank of Richmond (2003).

from the outset, with this precedent in mind and with a consensus around the fact that no deviation from the single monetary policy stance should be allowed.

Monetary policy decisions are indeed clearly centralized at the level of the ECB's Governing Council. NCBs' Governors also bring to the Council analyses prepared by their own staff. As indicated earlier, this can only contribute to enrich the Council's discussions and decisions.

As soon as decisions are taken, they are decentrally implemented in an unambiguous manner: the ECB's Executive Board sends instructions to NCBs on the basis of the Governing Council's decisions (Treaty article 12.1). There is regular ECB monitoring of the compliance of the whole system with these instructions and there are regular and extensive audit missions for the main activities.

Examples of this mode of functioning come easily to everyone's mind as regards the "downstream" conduct of monetary policy: refinancing, interventions on foreign currencies, management of foreign reserves, issuance of banknotes, etc...., after decisions have been taken. One should also bear in mind NCBs' operational role "upstream", before decisions are taken, in particular in the collection of statistics which are indispensable for good decision-making.

Another significant channel for this NCBs' upstream role lies in their participation in the ESCB committees (see section 2.5 below) and in the latter's work which contributes to the decision-making bodies' reflections and, ultimately, to the Governing Council's decisions.

2.2 Communication on Monetary Policy

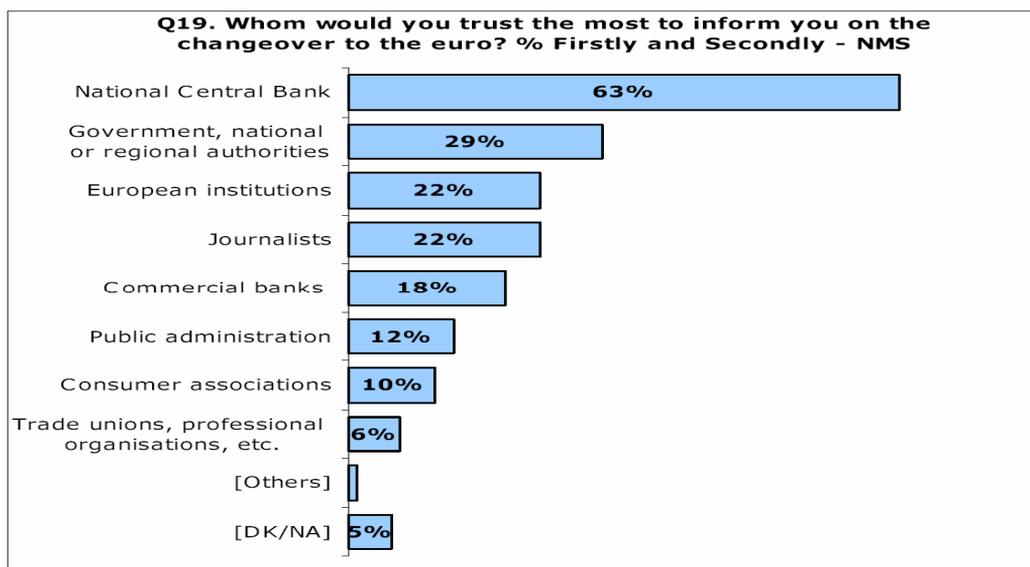
Central banks have to explain their decisions to economic agents through appropriate communication. In this regard also, NCBs contribute, together with the ECB, to the necessary activities through their own speeches, articles, conferences, interviews, auditions and publications but also through their role in translating, in their national language, most ECB publications. The language networks put in place by Banque Nationale de Belgique, Banque Centrale du Luxembourg, Banque de France for the French language, Oesterreichische Nationalbank and Deutsche Bundesbank for the German language, etc... help the ECB, which did not need to build a huge translation service. And this might help get the monetary message out, in terms that are closer to the language actually used in the different countries.

One should also stress that the role of NCBs – which is already very significant in day-to-day communication – is even more crucial in exceptional circumstances. An illustration of this took place on the occasion of the changeover to the euro. At that time, the Eurosystem ran what might have been the first communication campaign at the European continent level, always using the two key principles: central decision (on the concept and the messages), decentralized implementation

(taking into account, inter alia, the idiosyncracies of national mindsets, media consumption habits and advertising markets).

NCBs' role in the System's communication is especially valuable since they seem to enjoy, naturally, a higher degree of recognition than more far-away European institutions. This proximity may be illustrated, for example, by a survey of new Member States' (NMS) citizens regarding their choice of preferred sources of information on their future changeover to the euro (chart 4).

Chart 4: NCBs as Reliable Sources of Information for Citizens



Source: Commission Staff Working Paper, Annex to the first report on the practical preparations for the future enlargement of the euro area, 2004.

2.3 International Activities

Managing an international currency like the euro requires a lot of activity in international fora. NCBs are necessarily present in this activity, in coordination with the ECB, since many of these international fora (e.g. G7, IMF...) are organized according to a "country" mode (which does not prevent those fora from increasingly incorporating regional integration in their reasoning and functioning). Also, many NCBs have, historically, built strong international networks and relationships with central banks and financial communities outside the euro area: Oesterreichische Nationalbank and Deutsche Bundesbank in Eastern Europe, Banco de Espana and Banco de Portugal in Latin America, Banque de France in

Northern and sub-Saharan Africa, Southeastern Europe and South East Asia, for instance.

These complementary networks add to the information gathered by the System and they reinforce the spreading of ECB messages as well as the visibility of the Eurosystem and of its positions.

2.4 Non-Eurosystem Tasks

It should also be noted that, in addition to their ESCB-related tasks, most NCBs perform a very wide array of tasks which have been –and continue to be – assigned to them by their national authorities – most prominently by their national Parliaments. This is an additional recognition of the NCBs professionalism and further illustration of their role in the national institutional landscape.

These non ESCB-related tasks (which, for instance, include banking supervision, financial consumers' affairs, government fiscal agent services) are certainly far from being minor since they account for a significant part of Eurosystem staff. This, by the way, should point to the need for more caution than usually used in some blunt comparisons of staff numbers between central banks in general and between the Eurosystem and the U.S. Federal Reserve System in particular.

But the key point, regarding “federalism”, is that the conduct of those tasks entails no contradiction with Eurosystem tasks and, once again, no deviation from the single monetary policy. Indeed, article 14.4 of the Statute provides for the principle of non-interference of these tasks vis-à-vis ESCB-related ones (and for the means of enforcing this principle).

2.5 Internal Organization of NCBs

Finally, it might be interesting to point to the way in which the working of the decentralized set-up has influenced the internal organization of NCBs. This influence has made NCBs contribution to the Eurosystem more efficient.

First, NCBs' contribution to the System does not stop at their preparing files for their Governor's Governing Council sessions and implementing the Governing Council decisions. NCBs staff directly contribute to Eurosystem decisions through their participation in the 13 ESCB committees, which help to prepare the decisions taken by the Eurosystem. In this sense also, NCBs contribute to the definition of the centrally-decided concepts, messages, and actions. Conversely, participation in these committees contributes – both for NCBs and ECB staff – to the nurturing of a common Eurosystem corporate culture.

Working through these kinds of networks is indeed a very “modern” way of functioning. It also has had structuring effects for NCBs. For instance, the sheer number of experts involved (roughly 110 directly participating, for Banque de

France, in Eurosystem meetings)⁹ has contributed to share international contacts among a higher number of people, in each national central bank, at younger ages and at more medium levels of responsibility, relatively, than in pre-Eurosystem times.

Second, participation in the Eurosystem has led to changes in the structures of the NCBs. We are not pointing here to reductions in the numbers of staff and branches that most central banks have experienced over the last decades: indeed, these reductions are largely independent of the creation of the euro and stem mainly from evolutions in economic activity and in currency distribution networks, which can be witnessed in most of the industrialized world, not just in the euro area. More directly related to the creation of the Eurosystem are reforms of NCBs' decision-making bodies (e.g. the 2002 reform in the Bundesbank board, 1999 refocusing and 2002 reduction in membership of Banque de France's Monetary Policy Council) and in reforms of NCBs services (restructuring of business areas – e.g. at Banque de France – to ensure more optimal contacts with their ECB/Eurosystem counterparts).

3. Conclusion

More generally, the creation of the Eurosystem team has led to a healthy competition and to a permanent benchmarking between the various team players: no member of the team would like to be perceived as a poor performer in the common endeavour. This is another significant advantage of implementing the decentralization principle.

In the end, this principle is very close to the subsidiarity principle which governs the EU officially – and perhaps not coincidentally – since the 1992 Maastricht Treaty (which provided that “the Community shall take action only if and insofar as the objective of the proposed action cannot be sufficiently achieved by the Member States”). Of course, legally speaking, subsidiarity does not apply to monetary policy, which was completely transferred to the Union level by the Maastricht Treaty. However, the Eurosystem experience shows that, in its spirit, subsidiarity applies, with great benefits, in organizational terms (Mersch, 2000; Trichet, 2002). Given the legal caveat, one could also call it the “proximity principle”: as already stated, citizens tend to be distrustful of far away institutions, linked, often unfairly, to the idea of bureaucracy.

In this regard, it might be noted that, in this presentation, we have pointed to several, key differences between the U.S. and European contexts. However, this

⁹ See also the same kind of data for the Oesterreichische Nationalbank in this volume Lindner and Dvorsky, Institutional Changes in the European Integration Process – the Austrian Experience.

above-mentioned distrust of far away institutions is a well-established phenomenon in the United States. And, as evidenced, *inter alia*, by the Constitution ratification process, this feeling has began to grow in Europe –perhaps partly as a natural result of increased Union powers.

In such a context, the decentralized set-up of the Eurosystem certainly might not, in itself, make its policy immune to criticism. But it might contribute to making the Eurosystem more able to “act locally” (in each Member State), “decide regionally” (for the euro area) and “play globally” (in international negotiations) (Sa et al., 2005). In all these three types of actions, NCBs play their role fully. To return to Jean Monnet’s statement, no NCB seems to have been “lost” in the transfer of sovereignty each one has accepted. Rather, they have been strengthened by their participation in the Eurosystem team led by the ECB. In this sense, for the NCBs, the euro was not a revolution but an evolution, not a declining *fin de régime*, but a new *raison d’être*.

References

- Comité pour l’étude de l’Union économique et monétaire, Rapport sur l’Union économique et monétaire dans la Communauté européenne (rapport Delors), 1989.
- European Central Bank, General Documentation on Monetary Policy Instruments and Procedures of the Eurosystem, February, 2005.
- Friedman M. and Schwartz, A. Monetary History of the United States 1867–1960, NBER, Princeton University Press, 1971.
- Goodfriend M., The Role of a Regional Bank in a System of Central Banks, Federal Reserve Bank of Richmond, Economic Quarterly, Volume 86/1, Winter 2000.
- Liebscher K., The Role of a National Central Bank within the ESCB as illustrated by the OeNB, Vienna, OeNB, May 1998.
- Watson M. C., Reinventing Euro Area Central Banks, Central Banking, No.14–2, November 2003.
- Meltzer A. H., A History of the Federal Reserve, Volume 1, 1913–1951, University of Chicago Press, 2002.
- Mersch Y., The Role of the Central Banks in Euroland: Institutional Aspects, March 28, 2000.
- Monnet J., Mémoires, Editions Fayard, 1976.
- Rapport intérimaire concernant la réalisation par étapes de l’union économique et monétaire (Rapport Werner), 1970.
- Sa S., Bonzom Ph. and Strauss-Kahn M.-O., Interactions entre dimensions économique et institutionnelle de l’intégration régionale: l’expérience européenne, Banque de France Monthly Bulletin, October 2005.

Trichet J.-C., The Eurosystem: The European Monetary Team, Oesterreichische Nationalbank, 30th Economics Conference, 2002.

The Federal Reserve Today, Federal Reserve Bank of Richmond, 2003.

Eurobarometer 54 Special, Europeans & languages, February 2001.

United States Census Bureau, Census 2000, Language Use and English-Speaking Ability.

The Development of the Division of Labour between the ECB and the NCBs

Alexandra Schober-Rhomberg
Oesterreichische Nationalbank

1. Introduction

Mr. Duisenberg, the first President of the European Central Bank (ECB), said in a speech he delivered in April 1997 at the Spring Meeting of the Institute of International Finance in Washington that the major challenge for the ESCB will be how the centre, i.e. the ECB, and the National Central Banks (NCBs) will relate to each other in the context of a centrally determined monetary policy and how the skills and expertise of the NCBs can best be used, without impairing the single nature of monetary policy. The European System of Central Banks (ESCB) will be characterized by central and decentral elements – the challenge will be to ensure the appropriate balance (Duisenberg, 1997).

This paper tries to give an outline on the development concerning the division of labour between the ECB and the NCBs, identifying the underlying developments and trends, since the inception of the Eurosystem. Hence, the focus is on the twelve Eurosystem NCBs and the tasks to be carried out by the Eurosystem. With a view to the different strategies and options for the division of labour the paper tries to capture not only the institutional but also the business aspects related to the different tasks. The identification of driving forces behind the developments in the division of labour and some conclusions round off the picture.

The Treaty on the European Union (in the following referred to as the Treaty) specifies very clearly the tasks to be carried out by the ESCB/Eurosystem, but in most cases is not specific about which part of the system should undertake them.

When looking at the terms used to describe the division of labour *centralisation* means that the ECB is solely responsible on the operative side for a business area and *decentralisation* means that all NCBs are collectively responsible for the operational implementation of a task or function for the Eurosystem.

As there are several choices for the division of labour under the decentralised approach, the term *specialisation* is used in case a specific task within the Eurosystem is delegated by the ECB Governing Council to be performed by one or a group of NCBs for the whole system. Up till now there has been no real

coordinated specialisation, but specialisation took place only on a voluntary basis. Nevertheless, the intention to generate synergies and to cooperate as much as possible is specifically mentioned in the organisational principles of the ESCB (ECB, 2005f). *Pooling* means that one or more NCBs together provide certain services for the whole Eurosystem on a collective basis. The term *consolidation* describes a reorganisation process within a decentralised approach that leads to a concentration within a few processing centres, but coordination takes place.

2. Basic Tasks of the ESCB

The basic philosophy in organising the Eurosystem is to have all decisions taken centrally by the ECB Governing Council. In this way uniformity of the single monetary policy can be ensured across the euro area. The implementation of decisions – that is operations, which in practice account for most of an NCB's work – is effected by the NCBs on a decentralized basis, coordinated by the ECB Executive Board (Liebscher, 1998) and by the federally organized structure of 13 ESCB/Eurosystem committees. The ECB and the NCBs are integral parts of a whole that is guided by a common set of rules, objectives and duties in both its internal and external relations. This underlines the federal character of the ESCB/Eurosystem and the institutional role of the NCBs as equal partners (Liebscher, 1998) within the ESCB.

The following section looks at the current division of labour among NCBs and the ECB as well as reforms and strategic decisions for change since the inception of the ESCB/Eurosystem. The business areas analysed are based on those mentioned in the Treaty and the ESCB Statutes. Definitions in the Treaty and the ESCB Statutes are very broad and constitute a loose framework in which the ECB and the NCBs have margin for manoeuvre to determine a more detailed division of labour.

2.1 Monetary Policy Preparation

Monetary policy decision making itself is centralised within the ECB Governing Council and is characterised by a team effort with a strong, but not dominant centre. The decisions are based on input provided by both the ECB and the NCBs.

Monetary policy preparation comprises the monitoring of (regional) economic development, forecasting, the preparation of economic, monetary and financial indicators, research and publication as well as econometric modelling. Research and Policy Departments of NCBs prepare Governors for ECB Governing Council meetings in their personal capacity on a national level on the basis of the ECB's aggregate data. Here the expression of alternative points of view is an important strength of a system of central banks (Goodfriend, 2000). Furthermore, the Governing Council needs to rely on regional information and intimate knowledge the NCBs have of their respective countries. Some NCBs have developed a

specialization, like the Banque Nationale de Belgique providing a leading business indicator.

The diversification of research within a system of central banks brings different analytical perspectives to monetary policy deliberations. This also gives to very active and engaged NCBs room to look into special topics and excel as experts in those topics. NCBs do not have to voice an opinion on everything and this might give a small NCB the competitive edge on some issues over larger NCBs with more research staff (Hochreiter, 2000). As to the division of labour among the individual NCBs, there is no general rule. Any specialisation so far is on a voluntary basis. NCBs have also specialised in economic knowledge concerning geographical areas with which they share or have shared special relationships, i.e. OeNB, Suomen Pankki, Banco de España.

Goodfriend (2000) points out, that the staff at the centre needs to take the lead in developing a macroeconomic framework within which diverse policy views can be expressed and debated productively.

Within the Eurosystem the development of a Monetary Policy Transmission Network and Inflation Persistence Network are good examples for such a cooperation.

2.2 Monetary Policy Implementation

The Governing Council of the ECB is responsible for formulating monetary policy, while the Executive Board of the ECB is empowered to implement monetary policy according to the decisions made and guidelines laid down by the Governing Council.¹ To the extent deemed possible and appropriate and with a view to ensuring operational efficiency, the ECB has recourse to the NCBs for carrying out operations which form part of the tasks of the Eurosystem. In fact, the Eurosystem's monetary policy operations are executed by NCBs under uniform terms and conditions in all Member States (ECB, 2005a).

The decentralised implementation ensures, that all financial institutions subject to minimum reserve requirements in the euro area are able to participate in standard open market operations and can access the standing facilities (ECB, 2002). It also ensures an element of continuity for counterparties as they can hold accounts at their NCBs. It also embodies an element of insurance against disasters, by operating from many locations across the monetary union. Finally, ongoing contact to market participants helps in the formulation of monetary policy and in the case of some NCBs in their supervisory responsibilities.

This business area, especially with a view to liquidity management, could easily be influenced by structural factors, such as increasing consolidation within the banking sector as well as an increase in cross-border mergers in the euro area. As

¹ Protocol on the Statute of the European System of Central Banks and of the European Central Bank, Article 12.1.

to a future subdivision of tasks, there is potential for specialisation or consolidation of operations in one or a few locations as the usefulness of implementing monetary policy from every NCB might diminish (Wellink, 2002).

2.3 Foreign Exchange Operations and Reserves Management

Contrary to the Federal Reserve System the Eurosystem handles its foreign exchange operations in a very decentralised manner. Currently, the NCBs are responsible for managing foreign exchange reserves on behalf of the ECB according to the instructions regarding acceptable instruments and benchmarks given by the ECB Governing Council (ECB, 2000) but according to their own risk preference.

2.4 Payment Securities and Settlement Services

Payment systems differ across the euro area. In this context, it is useful to make a distinction between wholesale and retail systems. Each NCB has its own wholesale payment system, based on their existing technologies and the European payment system TARGET (Trans-European Automated Real-Time Gross Settlement Express Transfer System) provides a common interface (16 national RTGS systems and the ECBs payment mechanism). TARGET works effectively as one pan-European system, but national differences remain.

Initially, even before EMU, it was decided that harmonisation should be minimal. But the heterogeneous nature of TARGET raised problems of both, efficiency and cost, i.e. difficulties with decentral components and software.

The ECB Council then decided in October 2002 to develop TARGET 2. It will replace the decentralised technical structure of the current TARGET system by a single technical platform (Single Shared Platform – SSP). It will feature new functionalities, designed to meet the future needs of financial markets that users requested in public consultation held in early 2003, and the Eurosystem is firmly committed to delivering TARGET 2 in 2007.

The most important innovation is the pooling of the technical infrastructure. Three Eurosystem central banks – Banca d'Italia, Banque de France and Deutsche Bundesbank – jointly provide the basis for the SSP and will operate it on behalf of the Eurosystem. The participation in TARGET 2 will be direct or indirect via a link to a direct participant (ECB, 2005b).

A trend towards consolidation can also be seen in securities settlement, especially due to the ongoing work of the European Commission and the ECB concerning the harmonisation of the infrastructure (ECB, 2005c).

3. Other Tasks of the ESCB

3.1 Advisory Functions

The Treaty confers advisory functions to the ECB and its governing bodies on a wide range of subjects. Normally the advisory functions are coordinated by written procedure. The central function of the ECB is due to its role of writing the first drafts and hence it has the possibility to define content and volume. The NCBs are certainly given the possibility to cooperate and correct and can still influence the final product. Altogether the volume of advisory functions increased over time.

3.2 Financial Stability and Prudential Supervision

The ECB, together with the Eurosystem, has three tasks in this field: financial stability monitoring, provision of advice and promotion of cooperation.² The Treaty does not confer any specific supervisory competences to the ESCB/Eurosystem as such.

The financial stability monitoring in order to assess the possible vulnerabilities in the financial sector, and its resilience to potential shocks is done in collaboration of the ECB with the NCBs and supervisory agencies. They are all represented in the ESCB Banking Supervision Committee.

Concerning prudential supervision not all NCBs are the leading authority in their countries. But, by explicitly assigning a role to the ESCB, rather than the ECB, the Treaty gives all parts of the system a role, although this institutional set-up requires creative solutions. In this respect an increasing harmonisation of standards among the NCBs and supervisory authorities of the ESCB as well as a better exchange of information is well under way. These are logical developments characterised by cooperation and coordination but not tendencies for centralisation.

The integration process in the sector of financial supervision is not directly driven by the Eurosystem, but by national as well as EU legislation and decision making, Basel II and the emergence of new national supervisory authorities. Hence, here is no Eurosystem driven division of labour.

Although the increasing internationalisation of banks will determine supervisory arrangements in the future, it is not obvious that centralisation will be the most effective response. Financial structures still differ widely across Europe and also the absence of any fiscal union plays a role here, as any major financial crisis is likely to have implications on national budgets.

² Article 105.4 and 105.5 of the Treaty and in Article 25.1 of the Statute of the ESCB.

3.3 Banknotes and Coins

Legally, both the ECB and the NCBs of the participating countries have the right to issue euro banknotes. In practice, only the NCBs physically issue and withdraw euro banknotes (as well as coins). The ECB does not have a cash office and is not involved in any cash operations. The legal issuers of euro coins are the participating countries. At the euro area level it is the European Commission that coordinates all coin matters. Hence, the production of coins is completely decentralised as decisions are taken in the Economic and Financial Committee (EFC).

Each NCB was responsible for deciding on the production arrangements for its initial supply of euro banknotes. Then in April 2001 the ECB Governing Council decided that, in the years following the cash changeover, production of euro banknotes will take place according to a decentralised production scenario with pooling. This means that, as of 2002, each NCB has been responsible for the production of an allocated share in the total production volume of euro banknotes in only a few denominations. Each NCB defines its own procurement rules for its own allocated production. Here certainly the NCBs bear in mind the interests of its print works.

In September 2004, the ECB Governing Council adopted a Guideline (ECB, 2004) setting out how euro banknotes would be procured in the future, taking into account the fact that several NCBs within the Eurosystem have in-house printing works or use private printing works rather than seeking tenders for the euro banknote production allocated to them. The single Eurosystem tender procedure establishes an open and transparent procurement system in accordance with the principle of an open market economy with free competition favouring an efficient allocation of resources.

In respect of the Eurosystem's role and responsibilities in the cash cycle, the ECB Governing Council agreed upon common principles and objectives in December 2004. It thereby provides a reliable framework for its partners in the cash cycle – i.e. the banking industry and cash-in-transit companies. In line with the principle of decentralisation, the NCBs are responsible for implementation at the national level, taking into account their respective national economic environments and banking structures, the existing NCB branch network and the relative shares of cash payments and/or longer term agreements. Altogether the consolidation of processes and systemic improvement strive to further enhance its effectiveness and efficiency in all areas, taking advantage of all the experience available and exploiting potential synergies and economies of scale wherever possible (ECB, 2000).

Concerning the design, security features and quality control a specialisation is possible, although only in cooperation with the ECB. The OeNB can serve as an example here, with Mr. Kalina winning the design contest for the euro, as well as

its role concerning counterfeiting, as it is responsible for the upkeep of the Counterfeit Monitoring System database.

3.4 International Cooperation

The Treaty³ states that the ECB should be the system's representative vis-à-vis third parties and the ECB Governing Council decides how this is arranged in practice. The multilateral international cooperation is clearly decentral with cooperation as normally the NCBs are represented in the international organisations and the ECB participates as an observer. Individual euro area countries remain responsible for the economic policies other than monetary and exchange rate policies, even though coordination mechanisms have been strengthened at the European Community level (e.g. in the areas of fiscal and structural policy). This means that the involvement of the ECB, the European Community and individual EU Member States in the process of international cooperation varies depending on the mandates of the relevant international organisations and fora as shown in the table below.

3.5 Statistics

In compiling statistics, the ECB is heavily supported by the NCBs. The NCBs (and, in some cases, other national authorities) collect data from credit institutions and other sources in their respective countries and calculate aggregates at the national level, which they send to the ECB. The ECB then compiles and disseminates the aggregates for the euro area (ECB, 2005d).

In general statistics are a growth sector due to the demands of the ECB which are often more ambitious than the present EU requirements. With regard to the need of extensive resources as well as to the cooperation with other national entities, any other division of labour than decentralisation seems difficult right now. Over the long term the arguments for national data collection might only diminish if national borders become less important from an economic perspective.

³ The Treaty, Article 111, Articles 3, 4, 5.1 of the Statute of the ESCB.

Table 1: Main International Organisations and Fora Involved in Economic Policy Cooperation

Organisation or Forum	ECB	NCB	Other
International Monetary Fund (IMF)	Observer Status	With the exception of Austria and Finland, where the NCBs are the competent authorities, responsibility is shared with the Government	184 Member States
Organisation for Economic Co-operation and Development (OECD)	The ECB acts as a separate member of the European Community delegation alongside the Commission	Co-representation with ministries in relevant committees	Ministries of 29 Member States
G7 ministers and governors	The ECB President represents the euro area when macroeconomic policy and exchange rate issues are discussed	Central bank governors of Canada, France, Germany, Italy, Japan, the United Kingdom and the United States	Finance ministers of the 7 countries, President of the Eurogroup
G10 ministers and governors	The ECB President has observer status	Central bank governors of Belgium, Canada, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland, the United Kingdom and the United States	Finance ministers of the 11 countries

Table 1 continued: Main International Organisations and Fora Involved in Economic Policy Cooperation

G20 ministers and governors	The ECB President	Central bank governors of the G7 countries plus Argentina, Australia, Brazil, China, India, Indonesia, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey	Finance ministers of the 19 countries; the President of the World Bank, the Managing Director of the IMF and the Chairmen of the IMFC and the Development Committee; the President of the Eurogroup
Bank for International Settlements (BIS)	ECB since 1999	50 central banks	
Basel Committee on Banking Supervision (BCBS)	Observer Status	G10 central bank governors	G10 finance ministers
Committee on Payment and Settlement Systems (CPSS)	ECB	G10 central banks plus Hong Kong SAR and Singapore	G10 finance ministers
Committee on the Global Financial System (CGFS)	ECB	G10 central banks	
Gold and Foreign Exchange Committee (GFEC)	ECB	G10 central banks	

Source: ECB (2001), OeNB.

4. Driving Forces

4.1 Treaty Framework and Decisions by the ECB Governing Council and the EU

The basic philosophy in organising the Eurosystem is that monetary policy can only be pursued centrally – it is indivisible by its very nature (Selmayer, 1999). All decisions are taken centrally by the ECB Governing Council. This way uniformity of the single monetary policy can be ensured across the euro area. In conducting operations within the ESCB's field of competence, the ECB relies on the NCBs whenever possible and appropriate. This apparently quite straightforward structure nevertheless allows ample room for manoeuvre in actual practice. It is up to the ECB Governing Council to decide the exact boundaries of the division of labour. The Mission Statement, Strategic Intent and Organisational Principles (ECB, 2005f) represent a first step towards defining general principles for such a division of labour.

In addition of course the EU legal framework has far reaching implications for the Eurosystem. The institutional set up of financial supervision, the areas of public procurement or competition can serve as examples here.

4.2 Financing the System

As NCBs are financially independent, they could theoretically do what they want to do – as long as it doesn't conflict with the Treaty and the decisions taken by the Governing Council - in and for the whole Eurosystem and then endorse their own budget for this activity. Such decisions might depend on the location of an NCB, the image it wants to project or what is permissible in its own political environment and national legal framework. They have the financial leeway to conduct their proper business or for example to pursue specialisation.

4.3 National Institutional, Legal and Political Framework.

The institutional set up of NCBs differs widely within the Eurosystem due to national requirements and historical development. It follows that NCBs work with a given organisation when formulating strategies and options for their particular "niche" within the Eurosystem. Usually they are trying to capitalise on their traditional strengths and special points of interest.

Furthermore, the diversity of national institutional structures has an essential impact on the NCBs role not only as domestic policy actors but also as key players within the Eurosystem. National conglomerates in the banking sector also impact the organisation of liquidity management in commercial banks and as a consequence the respective NCB. Another example are the different roles the

individual NCBs play in the field of banking supervision, not a competence of the ESCB per se, but which involves a lot of coordination within the system. What's more, the less political union we have, the more of a role there is for NCBs as national policy actors.

4.4 Business and Operational Aspects

Business and operational aspects are certainly also a decisive factor in the development of the division of labour. Often sheer logic prevails. The size of an NCB in terms of financing and resources certainly matters concerning costs, quantity as well as quality. Market power as well as political power must not be neglected.

Economies of scale might work to the advantage of bigger NCBs. The pooling offered by the Deutsche Bundesbank, the Banca d'Italia and the Banque de France for TARGET 2 stands as an example.

Competition among institutions, for example in the research activities of the ESCB, can be seen as an incentive for new ideas and results, enhancing the quality of the decision making process and possibly leading to specialisation or consolidation.

Smaller NCBs might ultimately be less interested in keeping up a full range of functions, as their capacities could be overextended. Indeed there are decisions that NCBs can, but need not fulfil certain operative functions. In this context however, smaller NCBs might act as quality leaders in other areas and make strategic use of their competitive advantage in for example geographic location and knowledge of staff. However, other influences like the local conditions of employment could slow down the flexibility of reaction to these new challenges.

5. Conclusions

All in all the Treaty provides a flexible enough framework to accommodate all sorts of different degrees of division of labour among the ECB and the NCBs, naturally depending on the task to be fulfilled by the Eurosystem. So far the decisions of the ECB Governing Council guarantee a decentralised approach which has proven to work very effectively. However, the decisions give enough leeway to NCBs for positioning themselves within the division of tasks and functions. To a certain extent it is up to them to define their proper approach to specialisation, pooling, etc. It can also be seen that there is not one best system concerning the division of labour in order to achieve effectiveness and efficiency in implementing the tasks of the Eurosystem. The different tasks and functions of the Eurosystem show each a different pattern of centralisation, decentralisation, specialisation, pooling and consolidation. Changes in the division of labour among NCBs and the ECB have occurred at different speeds and are as a consequence in different stages of development within the Eurosystem. Finally, it can also be said that size,

political, business and operational aspects matter for the future positioning of the individual NCBS.

References

- Duisenberg, Wim (1997), Address held at the Institute of International Finance in Washington on 29/4/1997, BIS Review 46.
- ECB (2000) Guideline of the European Central Bank of 3 February 2000 on the management of the foreign reserve assets of the European Central Bank by the national central banks and the legal documentation for operations involving the foreign reserve assets of the European Central Bank (*ECB/2000/1*), <http://www.ecb.int>
- ECB (2001), The ECB's relations with international organisations and fora, ECB Monthly Bulletin, pages 57–75, January, <http://www.ecb.int>
- ECB (2002), The single monetary policy in stage three. General documentation on Eurosystem monetary policy instruments and procedures, April, <http://www.ecb.int>
- ECB (2004), Guideline of the European Central Bank of 16 September 2004 on the procurement of euro banknotes (*ECB/2004/18*), <http://www.ecb.int>
- ECB (2005a), The implementation of monetary policy in the euro area: General documentation on Eurosystem monetary policy instruments and procedures. 21, February, <http://www.ecb.int/press/pr/date/2005/html/pr050221.en.html>
- ECB (2005b), Overview of TARGET, July, <http://www.ecb.int>
- ECB (2005c), TARGET2 – Innovation and Transformation, August, <http://www.ecb.int>
- ECB (2005d), ECB Statistics – A brief overview; August, <http://www.ecb.int>
- ECB (2005e), The euro banknotes: developments and future challenges, ECB Monthly Bulletin, pages 41–47, August, <http://www.ecb.int>
- ECB (2005f), Mission Statement und Organisational Principles
- Goodfriend, Marvin (2000). The role of a regional bank in a system of central banks. Federal Reserve Bank of Richmond, Economic Quarterly, Volume 86/1, Winter 2000.
- Hochreiter, Eduard (2000), The role of National Central Banks in the Eurosystem: Current state of play, Atlantic Economic Journal, September (Vol. 28, No. 3), pages 300–308.
- Liebscher, Klaus (1998). The role of a National Central Bank within the ESCB as illustrated by the OeNB, speech held at the 26th Economics Conference of the OeNB, May, Vienna.
- Selmayer, Martin (1999), Wie unabhängig ist die Europäische Zentralbank?, Zeitschrift für Wirtschafts- und Bankrecht, 49, pages 2429–2480, December
- Wellink Nout, Chapple Brian and Maier Philipp (2002), The role of national central banks within the European System of Central Banks: The example of De Nederlandsche Bank, Netherlands Central Bank, Amsterdam.

Optimal Central Bank Design: Benchmarks for the ECB¹

Helge Berger

Free University Berlin & CESifo

Abstract

The paper discusses key elements of optimal central bank design and applies its findings to the Eurosystem. A particular focus is on the size of monetary policy committees, the degree of centralization, and the representation of relative economic size in the voting rights of regional (or sectoral) interests. Broad benchmarks for the optimal design of monetary policy committees are derived, combining relevant theoretical arguments with available empirical evidence. A new indicator compares the mismatch of relative regional economic size and voting rights in the monetary policy committees of the U.S. Federal Reserve System (Fed), the pre-1999 German Bundesbank, and the European Central Bank (ECB) over time. Based on these benchmarks, there seems to be room to improve the organization of the ECB Governing Board and current plans for reform.

JEL codes: D72, E58

Keywords: Central bank design, federal central banks, ECB, Eurosystem, ECB reform.

1. Introduction

The institutional underpinnings of decision-making in monetary policy show a considerable amount of time-path dependency or persistence – and for most purposes this is a good thing. Well-defined rules about who gets to decide about interest rates and in what form are commonly thought of as hallmarks of central bank independence, which most observers hold to be a key ingredient for price stability. And indeed, once economic agents and markets have settled on a view of

¹ I would like to thank the OeNB for its hospitality and Carsten Hefeker, Till Müller, Volker Nitsch, and Nathan Sheets for helpful comments and suggestions.

the institutional set up of a central bank, changing the rules of the game may be risky.²

Notwithstanding this persistence, remarkable changes in central bank organization do occur. Prominent examples include the early history of the U.S. Fed until the 1930s, the reshaping of the Bundesbank after German unification in 1992, or the granting of independence to the Swedish Riksbank and the Bank of England in the late 1990s. Moreover, the 1990s were also a period in which a large number of central banks were founded (or restituted) in transition economies, some of which continued to adjust (or still are in the process of adjusting) their institutional framework to meet the requirements of European Union (EU) and euro area membership. A final example is the founding of the ECB itself and recent organizational changes of the ECB statute in anticipation of the enlargement of the European Economic and Monetary Union (EMU).

The reasons behind observed changes in the decision-making framework for monetary policy vary, but jointly they put a spotlight on the question exactly what we should be looking for in optimal central bank design from an economic perspective.³ While central bank design has many dimensions, three basic issues stand out: First, how many people should be responsible for monetary policy decisions? Second, how much weight should be given to central versus regional (or sectoral) representation in decision-making? And, third, should regions (or sectors) be represented according to their economic weight? These questions are more than just of theoretical interest; they were also very much at the center of debate when EMU enlargement forced a discussion of ECB reform.⁴

The present paper will address these questions from an economic perspective, drawing on a still growing literature on optimal central bank design addressing these (or related) issues. As to *size*, Gerlach-Kristen (2002) argues that multiple-member committees handle information processing better than individuals, which

² In principle, this point extends to changes in monetary policy strategy – for instance, the recent discussion about the pros and cons of moving the U.S. Federal Reserve closer to an inflation targeting framework in the post-Greenspan era (see, e.g., Faust and Henderson 2004). However, in what follows the focus remains on the decision-making framework. Berger et al. (2001) provide a recent survey on central bank independence in general.

³ This is not to say that actual central bank design does not also reflect political-economic forces. However, in what follows the focus will be mostly on guidelines for efficient central bank design and, thus economic arguments.

⁴ The details of the 2003 ECB reform have been discussed extensively elsewhere – in what follows, we will focus on some relevant aspects of the reform. For a more extensive analysis of the issues involved see, among others, Hefeker (2002), Berger (2002), Gros and others (2002), Dvorsky and Lindner (2003), Meade (2003), Berger et al. (2004), de Haan et al. (2004).

suggests efficient decision-making is best handled by groups. Experimental evidence supports this view (Blinder and Morgan, 2005, Lombardelli, 2005).⁵

Regarding *centralization*, von Hagen and Süppel (1994) and Lohmann (1998) discuss the trade-offs involved in organizing a monetary policy committee as a more or less centralized institution, arguing that, as a rule, a strong representation of regional interest in the Council leads to inefficiencies in policy making.⁶ Lohmann's (1997) results suggest that increasing the number of votes of regional central bank governors compared to centrally appointed Board members may result in unwanted monetary policy volatility because it increases the frequency at which the median voter position changes in the policy committee. On the other hand, the results in Moser (1999) and Hallerberg (2002) imply that one advantage of regional representation, if going along with regional powers being involved in defining the central bank's legal setup, can foster the institutions political independence by adding further veto players on the legislative side. Goodfriend (2000), Berger (2002), and Maier et al. (2003) provide yet another argument in favor of limited centralization, suggesting that economic information is mostly regional in nature, and having regional representatives within the Council could enhance the precision with which economic data is perceived and analyzed. Finally, Hefeker (2003) argues that a central bank's design will, in part, depend on the economic heterogeneity of the economic area it represents. In particular, a decision-making setup that gives much weight to regional interests can be expected in a country that exhibits considerable divergences in terms of economic structure and preferences. In this case, regional political powers are likely to resist delegation of monetary policy to a centrally appointed board that focuses its decisions on the (weighted) average of economic developments in the currency area and might have different preferences than the regions.

A third group of relevant papers is related to the question of *representation*. These papers take the size of the Governing Council and a (less than full) degree of centralization as given, and ask how to deal with shocks to national preferences within such a federal central bank system. Waller and Walsh (1996) suggest overlapping contracts for monetary policy committee members as an institutional device to moderate the impact of regional preference shocks – a point also stressed by Lindner (2000). Gersbach and Pacht (2004) propose flexible majority rules for committee decisions, raising majority requirements for policy proposals (motivated, for instance, by idiosyncratic national shocks) in line with the size of the desired interest rate change. The advantages of alternative decision-making

⁵ Gersbach and Hahn (2001) look at related issues focusing on transparency. See Gerling et al. (2003) for a recent survey.

⁶ Throughout the paper, the term “regional” will refer to the jurisdictional level represented in the monetary policy committee in addition to Board members. Thus, in case of the Fed, “regional” will imply the states, in case of the ECB, the countries or nations forming the union.

arrangements, including simple majority voting, are also discussed in Bullard and Waller (2004) within a general equilibrium framework. Heisenberg (2003) favors increasing the transparency of committee decisions to reduce incentives for regionally biased policies (see also Gersbach and Hahn 2001). Finally, Berger and Müller (2005) show that over – or underrepresentation of economic size through asymmetric voting weights or rotation schemes can be helpful to moderate the impact of regional preference shocks on a monetary policy aimed at stabilizing output and inflation in a currency union overall.

In addition to exploring core arguments regarding optimal size, centralization, and representation in central bank design, the present paper adds an empirical perspective regarding the size and structure of monetary policy committees. Empirical perspective, in addition to illuminating the sometimes surprising variety in the way central banks are set up, provides orientation regarding more common (and, thus, perhaps more workable) solutions to some of the trade-offs that theory can describe but (for the most part) not decide.

The remainder of the paper is organized as follows. Section 2 will highlight the basic central bank design problem and develop broad benchmarks for monetary policy committees. Section 3 will apply these benchmarks to the Eurosystem before and after euro area enlargement. section 4 concludes.

2. The Basic Design Problem

The question of central bank design has many dimensions, both theoretically and empirically. In recent years, the theoretical debate has focused on a wide range of topics, from the question of transparency or communication to the virtues of inflation targeting, among other things. At the same time, European policy makers debated the pros and cons of topics such as central bank involvement in financial supervision, a Lender-of-Last-Resort function for the ECB, or its role in organizing real-time settlement systems within Europe. In what follows, however, the focus will be on the way a central bank should organize the way it reaches decisions on monetary policy.

2.1 Size: How Many People Should Be Responsible For Monetary Policy Decisions

Without doubt, size, that is, the number of people explicitly or implicitly involved in monetary policy decisions, is among the more important dimensions of central bank design. There are costs and benefits of a larger committee. As to the *benefits*, Gerlach-Kristen (2002) shows that multiple-member committees are better able to form a view on the state of the economy than a single individual that relies mostly on his or her own information and judgment. Faced with an uncertain environment – for instance, regarding the current or expected levels of the output gap –

committee members can pool individual information, cooperate in information processing, or give more productive members a larger relative weight in the process. As a rule, this will lead to better informed decision making.⁷ Blinder and Morgan (2005) and Lombardelli et al. (2005) second this argument based on empirical result from experiments.

On the *cost* side, there is reason to believe that decision-making costs increase in committee size.⁸ One important aspect is communication. Even if the exchange of ideas is limited to short introductory statements by each member, larger committees will easily spend considerable time just taking note of positions. In addition, actual decision-making costs are likely to have a non-linear component. For instance, if there is a need or tradition to “sound each other out” bilaterally before or during committee meetings, the time required to prepare a decision grows non-linearly in the number of members.⁹ Moreover, if diversity of opinion is increasing in the number of committee members, reaching an agreement might require more effort by all involved. Richard Baldwin (2001) aims in this direction, when he (somewhat exaggeratingly) suggests that – in the absence of reform – euro area enlargement will leave the ECB Governing Council with “too many (members) to decide on where to go to dinner, let alone agree on how to run monetary policy for more than 400m people...”.

To illustrate, consider a monetary policy committee that prepares decisions through (i) a series of pre-meeting bilateral negotiations, during which each member interacts with each other member, and (ii) a “tour d’horizon”, a short intervention by each member during the actual committee meeting. Assume further that both actions require a similar effort. Then the overall preparatory effort, that is, decision-making costs, C , of the committee would be

$$C(n, e) = n(n+1)\frac{e}{2},$$

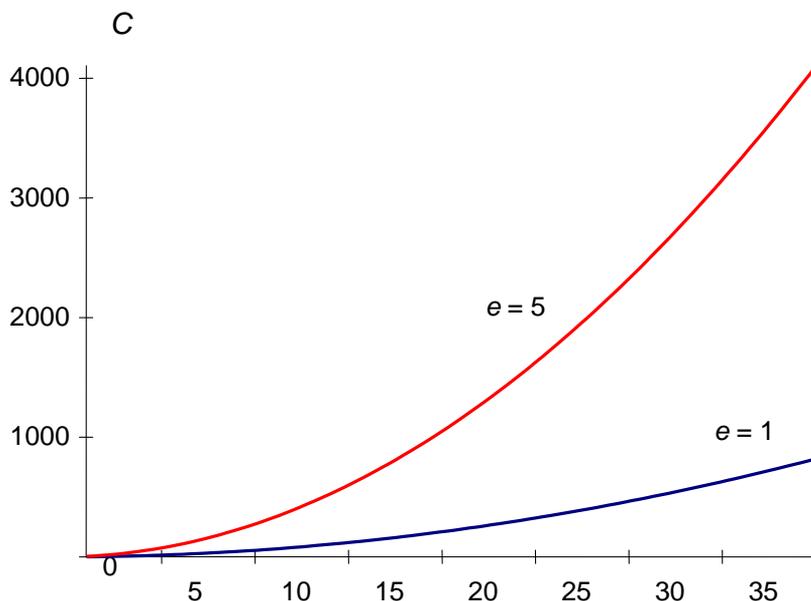
with e measuring effort (and/or time) and n the number of committee members.¹⁰ Chart 1 depicts the exponential form of the cost function for two alternative values of e .

⁷ Gerling et al. (2003) provide a recent survey of the emerging literature of decision-making in committees.

⁸ Blinder and Morgan (2005) argue that, to a degree, small groups of individuals may be able to reach a decision at a speed broadly comparable to an individual. It seems doubtful, however, whether this extends to larger committees of the order of magnitude relevant for the ECB or Fed.

⁹ Barber (2001) argues that bilateral meetings are a relevant practice in the ECB.

¹⁰ If n is the number of committee members, the number of bilateral discussions is $\frac{1}{2}n(n-1)$.

Chart 1: Decision-Making Costs: an Illustration

Source: Author's calculations.

For instance, if effort was measured in minutes spend on decision-making and only five minutes were required for each “tour d’horizon” and bilateral discussion ($e = 5$), a committee of nine would spend about four hours, a committee of 18 about 14 hours, and a committee of 27 more than 30 hours preparing a decision – no small amount of time when speed is of the essence.

For a given number of committee members, decision-making costs are also influenced by the particular way or mechanism decisions are reached. For instance, about half the close to 90 central banks surveyed by Fry et al. (2000) – including the Fed and the ECB – seem to follow a consensus-oriented approach. This approach requires all monetary policy committee members to verbally agree on a certain decision before a vote is called. Arguably, finding a consensus will take more time and effort and, thus, imply higher decision-making costs than a simple voting rule.¹¹ This could be because under a strict voting rule some of the decision-

¹¹ These costs can be mitigated by leadership, for instance because the Board initiates and prepares many committee decisions (e.g., von Hagen and Brückner, 2001), but surely that leadership ability, too, will face greater challenges as the number of committee members increases. Baldwin and others (2001) argue, for instance, that EMU enlargement might make it more difficult for the ECB Board to find sufficient support for monetary policy

making costs discussed above would not accrue (policies would simply be proposed and voted upon without prior consultation or exchange of statements) or because no additional time and effort would be spent on consensus finding and bargaining during the meeting.¹²

On the other hand, simple voting mechanisms – despite their possible advantages regarding decision-making costs – may have disadvantages regarding the quality of decisions. For instance, Gerlach-Kristen (2002) shows formally that optimal signal extraction procedures might deviate from simpler mechanisms, including averaging the available information or majority voting on it (i.e., using the median rather than the mean), if committee members are not equally skilled in processing information.¹³ In a broadly related vein, Gersbach and Paehl (2004) argue that, if preferences of decision makers have an unwanted regional bias, conventional majority rules might lead to inferior policy outcomes compared to more elaborate voting rules. They show, for example, that monetary policy would be less likely to be biased by regional considerations if majority requirements were a positive function of the size of the desired interest rate change. One implication of this type of argument is that the presence of non-voting decision-making procedures in policy committees may well be efficient in information terms. As a consequence, it would be hard to argue in favor of voting-based procedures on the basis of lower decision-making costs alone.¹⁴ Whatever the procedure, however, the question remains, how large the monetary policy committee should be.

measures with a proper euro area perspective. See Blinder and Wyplosz (2004) for a “typology” of monetary policy committees based on the degree of internal leadership.

¹² The difference between consensus-based and vote-based approaches may be even larger, if there was a difference in the number of voting and non-voting members. For instance, there are 19 members that participate in the Fed’s FOMC meetings – all seven Board members plus the 12 regional Fed presidents – but at any given meeting only five out of 12 regional representatives hold a right to vote. If, as already indicated, the FOMC indeed reached decisions by consensus, all members would be involved and decision-making costs are likely to be significantly higher than under a simple majority rule voting procedure that would effectively exclude non-voting members. The same applies to the ECB’s Governing Council once more that 15 national central bank governors participate in Governing Council meetings, with only 15 voting rights rotating among them following the 2003 ECB reform (Servais 2006, in this volume).

¹³ This suggests the possibility of free-riding: if processing information is individually costly, there might be incentives to hope that other committee members provide the public good. This mechanism would add to the cost of increasing membership size. Fry et al. (2000, p. 129), too, stress that informational aspects should limit the maximum size of the “ideal” monetary policy committee.

¹⁴ Another problem with such a recommendation would be that it might all but impossible to force a committee *not* to prepare a voting decision through more or less intensive preparatory communication and negotiation.

Weighing costs and benefits, the optimal size of a monetary policy committee is likely to be a moderately large number. While the information-related arguments on the benefit side suggest that single-person committees are not efficient, the overall number of participants should remain limited in the presence of exponentially increasing decision-making costs. The question remains what exactly “moderately large” means. In the absence of systematic empirical work linking the size of monetary policy committees to the achievement of policy targets, it is at least informative to note that the average size of committees is clearly larger than one and seems to be closer around ten than 20 (Lybeck and Morris, 2004). The upper panel of table 1 shows the distribution of central bank governing bodies that are concerned with setting policy goals (about 50 out of 95 countries surveyed in the sample) as well as the distribution of bodies implementing and/or deciding monetary policy. The data do not allow computing means, but the median in both categories falls into the 7–9 and 10–12 member range, respectively. The median monetary policy committee surveyed by Fry et al. (2000) has 5–10 members.

The information in the lower panel of table 1 lists (somewhat more precise) information on the size of monetary policy committees for selected developed economies, with interesting implications for the ECB. The table suggests that the ECB’s Governing Council, with currently 18 voting members is among the larger ones (even) in this sub-sample, comparable only to the Fed’s Financial Open Market Committee (FOMC) or the pre-1999 Zentralbankrat of the German Bundesbank (BuBa). As a rule, centralized central banks operate under smaller monetary policy committees closer to the median values found in the upper panel of table 1. If, however, euro area membership were to increase from today’s 12 to 24 members – a likely scenario, with, for instance, the eventual entrance of the ten new EU Member States as well as likely future candidates such as Rumania and Bulgaria – the Council would comprise 30 members.

*Table 1: Number of Members in Governing Bodies 2003**(a) Distribution*

	<i>Distribution of Members (in %)</i>					<i>Observations</i>
	<i>1–3</i>	<i>4–6</i>	<i>7–9</i>	<i>10–12</i>	<i>≥ 13</i>	
Policy Committees	4	28	47	11	10	50
Implementation Committees	4	10	10	40	40	95

(b) Selected Examples

<i>Bank (Federal)</i>	<i>Number</i>	<i>Bank (Central)</i>	<i>Number</i>
Bundesbank pre-1957	10	Australia	9
Bundesbank 1998	17	Canada	7
Fed	12 (19) ^a	New Zealand	1
ECB (2001)	18	Sweden	6
ECB (EMU-24 ^b)	21 (30) ^a	UK	9

Source: Lybek and Morris (2004), Berger (2002).

a: The FOMC has 12 voting members, but there are 19 regular members participating in discussion and consensus-finding. Taking into account the ECB reform of 2003, the ECB Governing Council would have 21 voting members and 30 members overall if euro area membership increased to a hypothetical 24 (see below).

b: “EMU-24”, an arbitrary example, could comprise the current 12 members plus the ten recent EU entries, as well as Bulgaria and Rumania.

The size of the ECB Governing Council will remain problematic even after the 2003 reform of the ECB statute. The reform will limit the number of voting seats of national representatives to 15 and freeze the number of voting Board members at six, restricting the maximum number of voting members to 21 in any reform scenario (ECB 2003, Servais 2006, in this volume). However, if all members present at Governing Council meetings de facto continued to participate in a consensus-based decision-making process, decision-making costs would still be likely to be significantly higher than in most other central banks, including federal

central bank systems.¹⁵ In this regard it is interesting to note that both the Bundesbank and the Fed reduced the size of their decision-making bodies over time (Berger, 2002). As Meltzer (2004) and Eichengreen (1992) illustrate, the present statute of the Fed's FOMC is the outcome of a historical process determined, among other things, by efficiency concerns. And one of the purposes of the German Bundesbank reform of 1992 was preventing an increase in the size of the Zentralbankrat German unification would have demanded. Before 1992, each German Land had a representative in the committee, and without reform, membership would have exceeded 22 – a number that, according to the Bundesbank, “would have greatly complicated that body's decision-making processes” (Deutsche Bundesbank, 1992, p. 50).

2.2 Centralization: How Much Weight for Regional (or Sectoral) Representation?

Given the size of the monetary policy committee, another relevant design problem is the degree of centralization – that is, the relative number of seats allocated to members nominated by regional (or sectoral) and central authorities. In the case of the ECB's Governing Council or the Fed's FOMC, for instance, this means to decide the share of Board seats.

In part, the answer hinges on certain assumptions about the heterogeneity of regions and the focus of local representatives. The question of centralization would be mute, if regional representatives' preferences were identical and regions did not differ in terms of economic structure and economic development, or if they focused not on regional issues but solely on the aggregate well-being of the currency area.¹⁶ Over- or under-representation of economic weight matters, however, if there is a chance that regions differ in economic terms or that their representatives in the monetary policy committee show differences in policy priorities or signs of a 'home bias'. We will return to the issue of “home bias” and diverse references below. Regarding regional economic heterogeneity, it is probably safe to assume that some of the surprisingly persistent differences in economic developments in particular within the euro area (and also, to a degree, within the U.S.A.) will

¹⁵ Remarkably, this view is shared, in part, by the ECB (2003, p. 83): “(Th)e participation of *all* (emphasis in original) governors at the meetings of the Governing Council will not necessarily make deliberations easier...” The ECB stresses, however, that “...the new voting system clearly enhances the efficiency of decision-taking.” (ibid.).

¹⁶ Baldwin et al. (2001, p. 30) echo an opinion often heard among central bank watchers when they write that, in principle, “the homogeneity of American states suggests that regional representatives on the Fed are less likely to have a regional perspective than would European regional representatives”. Thus, a regional perspective in itself might be unproblematic as long the regional heterogeneity is low enough.

continue to be pose challenges to aggregate monetary policy in the foreseeable future.¹⁷

The argument on the *benefits* of centralization has more than one aspect, but the general idea is that strong regional (or sectoral) representation in the monetary policy committee might lead to inefficiencies at the aggregate level.¹⁸ A first approach leading to this conclusion focuses on preferences. For instance, assuming partisan preferences over monetary policy, Lohmann (1997) argues that a centralized committee, with relative fewer members appointed at the regional level, will see fewer changes of the committee's median voter and, as a consequence, a less volatile monetary policy. Another starting point is the possible presence of a regional bias in decision making of regionally appointed committee members (von Hagen and Süppel 1994).¹⁹ To take an extreme case, assume that regional representatives focus solely on local developments while the central bank's legally defined responsibility is to ensure that an area-wide target is reached. A relevant example is the Maastricht Treaty that defines the ECB's goals as price stability based on the harmonized euro area CPI index (HCPI), computed by Eurostat as the properly weighted average of regional HCPI indices. If regionally appointed members have a regional focus and ignore the aggregate, monetary policy could deviate from that ideal.²⁰ Thus, one benefit of increasing the relative number of centrally appointed members in a monetary policy committee could be the absence of a regional bias in decision making.

The notion of a "home bias" of regionally appointed committee members is not completely implausible. Even though, for example, the ECB (1999, p. 55) stresses that all members of the Governing Council act in "a fully independent personal capacity" and not as "national representatives," regional economic considerations might indeed inform the behavior of governors in the Council. This assumption is certainly popular with the academic literature (see, among others, Lindner 2000, Aksoy et al. 2002, Gros and Hefeker 2002, Gersbach and Pachtl 2004, and Frey 2004) as well as the media. For instance, The Economist (1998) stated with regard to the ECB that "(t)he Governing Council is supposed to set interest rates according to conditions in the euro area as a whole, but there is a risk that national governors will be unduly influenced by conditions in their home country.... A weak

¹⁷ See, for instance, de Haan et al. (2004) for a survey of the empirical literature. Giannone and Reichlin (2005) provide a very recent discussion of the relative economic diversity of the euro area.

¹⁸ For the sake of brevity, in what follows, the focus will be on regional representation alone.

¹⁹ Conclusions broadly along this line were prominently featured in a number of papers written prior to the establishment of the ECB. See, among others, Lohmann (1998).

²⁰ There is an implicit assumption that the decision-making mechanism does not implicitly or explicitly weigh individual opinion in a way that leads to policies compatible with the aggregate target – we will return to this issue in section 2.3.

center, combined with strong national interests, could create conflicts that undermine the whole system's credibility.”

What is more, there is empirical evidence of regional influences in federal central bank systems. Meade and Sheets (2005, 2006, in this volume) document and analyze FOMC voting patterns since the late 1960s and show that decision makers, in addition to aggregate concerns, take into account regional factors when casting votes on monetary policy.²¹ Meade and Sheets also find that, as a rule, regional Fed bank presidents have been more likely to dissent from the FOMC's majority vote than Board members. Berger and de Haan (2002) provide comparable evidence for the voting behavior of regional central bank governors in the Bundesbank's Zentralbankrat. They show that the probability of a regional representative to vote against the majority vote increased in the difference between their respective regional and national economic developments, in particular inflation and real GDP growth.

There are, however, also *costs* associated with decreasing the vote share of regional representatives in the monetary policy committee. One argument in favor of a strong regional presence rests on checks and balances. If the power to nominate committee members is shared among, say, federal and regional governments, it is less likely that monetary policy will be influenced by the political whims of either level of government, leading to a higher factual independence.²² The logic is borrowed from Moser (1999), who stresses the advantage of additional legislative veto players for the central bank's institutional independence (see also Hallerberg 2002). The Bundesbank seemed to support this view, when it called the continued presence of regional governors in the Zentralbankrat after the 1992 reform an “important element in the Bundesbank's...independence” (Bundesbank 1992, p. 49–50).

A second cost factor associated with increasing degrees of centralization may be loss of information. As pointed out by Goodfriend (2000), much of the information relevant for monetary policy originates at the regional level, and a good understanding of regional developments is of special importance in diverse economic environments such as federal currency unions. Therefore, a strong regional presence in the monetary policy committee will have its advantages also from an informational perspective (Berger, 2002). Maier et al. (2003) provide an

²¹ Earlier work on FOMC voting includes Havrilevsky and Gildea (1995), and Tootell (1991). Heinemann and Huefner (2004) and Meade and Sheets (2002) argue that there might even be indications of regional voting behavior in actual ECB policy. Chappell et al. (2005) provide an extensive analysis of political-economic influences on individual voting behavior in the FOMC.

²² We will return to a similar argument when we discuss the issue of representation of economic size.

interesting formalization of the argument.²³ A similar argument could be made regarding differences in transmission mechanisms of monetary policy (Gros and Hefeker, 2002, Benigno 2004).

Table 2: Structure of Governing Bodies 2003

(a) Distribution

	<i>Distribution (in %)</i>				<i>Observations</i>
	<i>Sectoral Representation</i>		<i>Regional Representation</i>		
	<i>Yes</i>	<i>No</i>	<i>Yes</i>	<i>No</i>	
Policy Committees	8	92	8	92	50
Implementation	7	93	7	93	94

(b) Selected Examples

	<i>Board</i>	<i>Regional Central Bank Governors</i>	<i>Overall Council Members</i>	<i>Political Weight of Governors in %</i>
<i>Federal central bank models</i>				
Bundesbank 1998	8	9	17	52.9
Fed	7	5 (12)	12 (19)	41.7 (62.2)
ECB	6	12	18	66.7
ECB (EMU-24)	6	15 (24)	21 (30)	71.4 (80.0)
<i>Centralistic central bank models</i>				
Australia	9	0	9	0
Canada	7	0	7	0
New Zealand	1	0	1	0
Sweden	6	0	6	0
United Kingdom	9	0	9	0

Source: Lybek and Morris (2004), Berger (2002).

Notes: Numbers without (with) parentheses indicate voting (non-voting) membership. See footnotes to table 1 for details.

What does this imply for the *optimal degree of centralization*? While the discussion so far seems to favor an intermediate solution, real world monetary

²³ Hefeker (2003) makes a related point – albeit from a political-economic perspective. He argues that regional authorities might resist a centralized design of a common central bank if their policy preferences differ from Board members and the local economy's economic structure deviates significantly from the average in the currency area.

policy committees tend toward the extreme. Table 2 (upper panel) shows that – based on the Lybeck and Morris (2004) data – the vast majority of central bank governing bodies is fully centralized. Only 8% of the governing bodies concerned with setting policy goals and only 7% of the bodies in charge of policy implementation have members representing regional or sectoral interest.

While most central banks laws stipulate no regional representation, those representing large federal systems or currency unions provide most of the exceptions, perhaps reflecting the greater economic and political heterogeneity compared to areas governed by more centralized central banks. Indeed, Alesina and Spolaore (2003) argue that there is a positive relation between the size (in terms of population) of a regional entity and the heterogeneity in preferences within its borders, and similar regularities might be at play regarding economic diversity.²⁴ Looking at the examples selected for in the lower panel of table 2, Germany, the U.S.A., and the euro area all fall into this category.²⁵

However, even if we restrict the comparison to the U.S.A. and Germany, the ECB shows the smallest degree of centralization. Focusing, first, on the distribution of voting rights, we find that the weight attached to regional representatives in the Bundesbank's Zentralbankrat and Fed's FOMC, at about 53% and 42%, respectively, is much lower than in the current ECB Governing Council, where regional governors hold about 67% of votes. This gap is bound to increase as EMU membership increases. In the hypothetical euro area with 24 members introduced earlier (see table 1), the political weight of regional governors rises to about 71% despite the 2003 reform of the ECB statute. Looking instead at total monetary policy committee membership including non-voting governors, the differences remain stark. At about 62%, the overall share of regional members in the FOMC is in the vicinity of today's ECB, but the ECB's figure would increase to 80%, if euro area membership increased to 24.

2.3 Representation: Should Regions be Represented According To Size?

Taking the size of the monetary policy committee and a certain degree of centralization as given, the question is whether the voting rights of regional governors (or their otherwise defined political clout within the committee) should be in line with the economic weight of the region they represent. In other words, should the committee be organized along what could be called the “one region, one vote principle”? As with centralization, the answer depends on the heterogeneity of

²⁴ Strictly speaking, Alesina and Spolaore (2003) are concerned with the size of nations – but the argument readily extends to trans-national bodies such as EMU. Rose (2005) provides some empirical evidence on the issue.

²⁵ Others are Switzerland and Tanzania. See Lybek & Morris (2004).

regions and the focus of local representatives. In what follows, we will continue to assume that regions may differ in economic as well as preference terms and that their representatives show signs of a “home bias”.

Under these assumptions, an obvious *cost* associated with the misrepresentation of economic size is that committee decisions might deviate from the first-best, defined as the policy a decision-maker looking at the properly weighted area average would have chosen. This would be particularly worrisome if, for example, a large region underrepresented in the monetary policy committee was characterized by a systematically more volatile (or less volatile) business cycle than other regions. Or consider the case of a small region being overrepresented in the monetary policy committee with inflation below the weighted inflation average or the currency union. In this case, a majority of committee members might favor a more expansionary policy stance than a single decision-maker focused on the aggregate. To avoid regional bias in monetary policy, the optimal voting weight of a given regional representative should exactly match the represented region’s economic weight. With perfect representation, committee decisions would replicate the decisions of a single decision maker focused on the aggregate.²⁶

Another issue could be accountability and credibility. Focusing on the euro area, Servais (2006, in this volume) points out that economic agents and politicians might simply not be content with a majority of small countries running monetary policy, leading to a credibility loss for the common central bank. This view is supported by Fahrholz and Mohl (2004, p. 1), who argue that “considerable loss of current EMU-members’ influence power especially in favour of joining Central and Eastern European Countries (CEECs) results in a loss of monetary credibility of the ECB: As transparency of the decision-making process within the ECB is lacking, markets may consider the ECB to be too much inclined to the economic performances of the CEECs.”

But there might also be *benefits* from misrepresenting economic size. One argument in support of the “one region, one vote principle” is political stability (Berger 2002). Assume, for the sake of the argument, that regional representatives’ policy preferences – e.g., their preferred inflation target or their views on the relative priorities of inflation and real policy goals – are subject to shocks of similar volatility. Then a more equal distribution of voting rights regardless of

²⁶ This is also true if monetary policy decisions are based on a bargaining approach as long as voting rights influence fall-back positions. See Berger (2002) for a formalization of the argument. See Bindseil (2001), Baldwin et al. (2001) and Fahrholz and Mohl (2004), among others, for a related discussion that takes into account coalition building. While the basic message stemming from this kind of analysis generally follows the gist of argument in the main text, there are differences. For instance, using the concept of a Banzhaf power index, Fahrholz and Mohr (2004) show that, under certain conditions, the ECB reform could actually amplify problems of misrepresentation compared to the pre-reform status quo.

economic size can help to mitigate the aggregate impact of these shocks by allowing regional preference shocks to offset each other, thereby moderating unwanted volatility of monetary policy decisions at the union level. Of course, if preference shocks differ in variance across regions, moderating the impact at the aggregate level would require a more asymmetric distribution of voting rights, but still one that would be independent of relative economic size.

This leaves us with the question of the *optimal degree of representation* of economic size. Some insight can be gained from the formal discussion of the trade-offs involved. Berger and Müller (2005) model the advantages of moderating regional preference shocks at the aggregate level (through a distribution of voting weights in line with the relative stability of preferences) and the benefits from preventing regional interests distorting monetary policy in the face of national or regional economic shocks (through conditioning voting weights on relative economic size). Optimal regional representation reflects economic size and the stochastic properties of economic and preference shocks. As a rule, “one region, one vote” will not be optimal, but neither will be a perfect alignment of voting rights and relative economic size. Under plausible conditions, the formal exposition supports some over-representation of relative smaller countries.²⁷

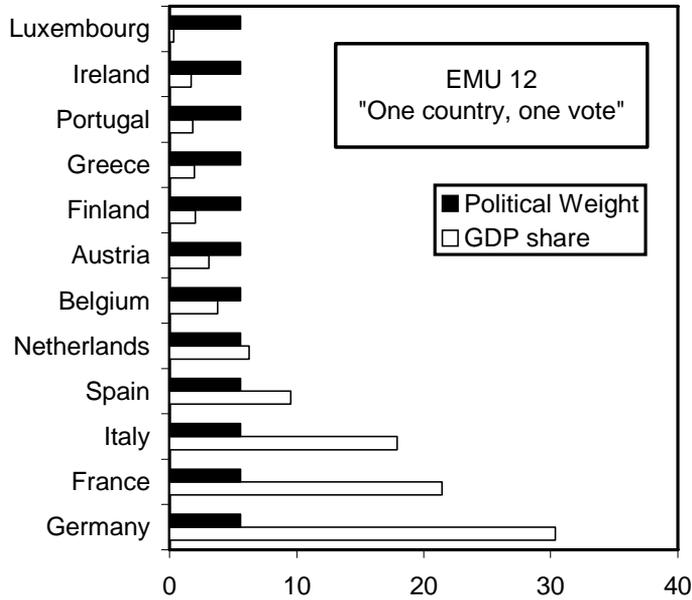
How regional governors are represented within the ECB’s Governing Council and how does this compare to other federal central banks? Providing a partial answer, chart 2 compares the relative economic size of current euro area members with the voting power allocated to the governors representing these members (upper panel). The lower panel provides the same information for the hypothetical EMU with 24 members taking into account the 2003 ECB reform. The reform, in addition to limiting the number of national central bank governors to 15, introduces an asymmetric rotation scheme organizing the way governors will exercise these voting rights once EMU membership exceeds the number of votes (ECB 2003). As euro area membership increases, governors will be divided into two and then three groups out of which they rotate into a limited number of voting seats. Country representatives will be allocated to groups by size, and groups encompassing larger countries hold more voting rights in the Governing Council.²⁸

²⁷ Reflecting the argument made above regarding the cost of misrepresentation, an increase in economic volatility will reduce the gap between relative economic size and optimal representation of a region (lowering the weight an overrepresented region receives and increasing the weight of underrepresented ones), while an increase in the volatility of preference shocks unambiguously lowers optimal representation.

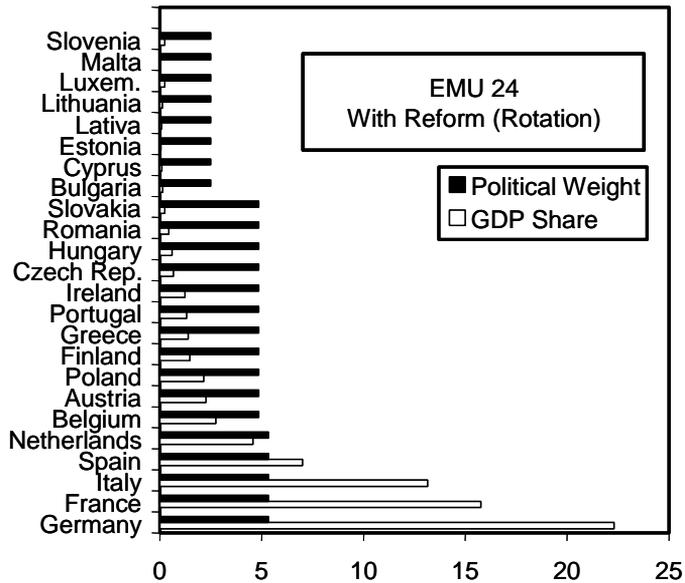
²⁸ Size is being measured by a so-called composite indicator that takes into account both relative GDP and financial market size. See, among others, Berger et al. (2004) for additional discussion of this aspect.

Chart 2: Distribution of Voting Rights and Economic Size in EMU

(a) Current Situation



(b) Hypothetical EMU 24

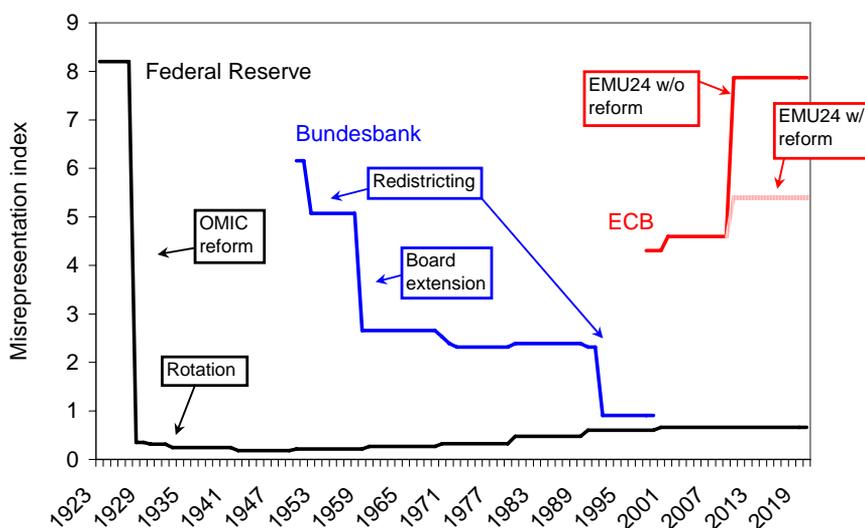


Source: ECB, IFS, and author's calculations.

Note: Relative size based on GDP.

Obviously, there are stark differences between the relative economic might of regions (or countries) and the way these regional interests are represented in the ECB's Governing Council in terms of voting weights. Under the "once region, one vote" rule – formally known as the "one person, one vote" principle – seven out of 12 member countries hold voting power in excess of their economic weight. After enlargement, taking the hypothetical EMU 24 scenario as an example, this discrepancy will be even larger. Despite the rotation scheme favoring economically larger countries, as many as 20 out of 24 members may be over-represented in term of relative economic size. It is, thus, not entirely implausible that, occasionally, an economic minority will decide monetary policy for the whole of EMU.

Chart 3: Misrepresentation of Economic Size



Source: U.S. Census Bureau, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, German Statistical Office, German Bundesbank, Meltzer (2003), and author's calculations.

Notes: The misrepresentation index measures the sum of the squared difference between regional vote shares in the monetary policy committee and relative economic size in a given year. Absent institutional reform, the data is updated in 10-year intervals. In case of the Federal Reserve, economic size is proxied by population shares until 1977 and GSP shares thereafter. Original population and GSP data are by state and are converted into Fed-districts on a county-by-county basis. (See main text and appendix for a discussion of the role of the Board until the 1930s.) In the case of the Bundesbank and ECB, relative GDP shares are used. In all three cases the regional vote share is computed as the sum of the vote share of the region's representative (president or governor) in the monetary policy committee plus the region's economic weight times the Board's vote share. The assumption behind the latter is that the weight that the Board attaches to developments in each region is strictly proportional to their relative economic size. However, relative results remain qualitatively similar under alternative assumptions about Board behavior – see table 3 below.

The question that chart 2 cannot answer is whether the ECB is indeed an outlier with regard to the degree of misrepresentation – after all, misrepresentation in the (pre-1999) Bundesbank or the U.S. Federal Reserve System might be just as sizable.²⁹ Chart 3 provides some perspective.

Chart 3 shows time series for the sum of the squared difference between regional vote shares in the monetary policy committee and relative economic size in a given year for the U.S.A., Germany, and the euro area. In case of the Federal Reserve, economic size is proxied by population shares until 1977 and GSP shares thereafter.³⁰ The regional vote share has two components. The first component is a region's own vote share in the monetary policy committee. The second reflects the fact that the Board, if Board members take a national perspective when casting their vote, will take regional developments into consideration. Assuming that Board members weigh regional developments according to a region's relative economic size, the second component can be calculated as the product of the Board's voting share and a region's relative economic size. While there is a range of alternative assumptions regarding the Board's voting behavior, the relative results presented in chart 3 are quite robust. We will return to this issue below.

A number of stylized facts emerge from chart 3. First, misrepresentation is not constant but changes over time, with institutional reform being the driving factor. While some of the developments depicted in chart 3 are due to shifts in relative economic size, the most visible changes are clearly determined by institutional innovations.³¹ Second, both the Fed and the Bundesbank significantly reduced misrepresentation over time. The institutional reforms that reduced the gap between economic and political weights included, in case of the Fed, the introduction of an asymmetric rotation scheme based on relative economic size in the mid-1930s, and, in case of the Bundesbank, the redrawing of the districts represented in the monetary policy committee in the 1950s and 1990s, which

²⁹ There are compelling reasons for putting the ECB's design into "historical" perspective by comparing it with the Fed. Still, Thygesen (1989, p. 91) might go too far when he states that "(i)t seems more instructive to look at the experience of an existing federal banking system which has evolved over the past 75 years than to start from more abstract notions of how such a system might be designed." Without theory, it is hard to tell whether the example set by the Fed provides worthwhile guidance.

³⁰ There is no straightforward way to pinpoint the voting share of the Board within the various predecessors of the FOMC between 1914 (when the Board held no votes) and the 1930s (when its share converged to today's level). See the Appendix for a brief synopsis of the Fed's history in this regard and the assumptions on Board voting shares based on this.

³¹ Some of the more important institutional changes are identified in the figure (also see the Appendix). On the history of the Fed, see, for instance, Meltzer (2003), Eichengreen (1992), and Thygesen (1989). On the Bundesbank, see, among others, Bundesbank (1992) and Berger (1997) and the references therein.

eliminated separate representation for some of the smaller regions. Another factor reducing misrepresentation in both cases was the strengthening of the Board – assuming that Board members are more likely to take a national rather than a regional perspective, increasing its relative vote share will help reducing the mismatch between regional representation in the monetary policy committee and economic size.³² That is part of what Eichengreen (1992, p. 14) may have in mind, when he writes that “(t)he early history of the Federal Reserve System...should be read as a cautionary tale. (...) It points to the advisability of reducing existing European central banks to mere branch offices of the ECB or of eliminating them entirely.”³³

Table 3: Comparing Misrepresentation of Economic Size in the ECB in 2001

	Federal Reserve	Bundesbank	ECB	Ratio ECB/Fed	Ratio ECB/Buba
(1) Board votes with region	0.66	0.91	4.60	7.0	5.1
(2) Board does not vote with region	5.54	5.70	33.33	6.0	5.9
(3) Board without voting rights	3.79	3.24	10.34	2.7	3.2

Source: U.S. Census Bureau, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, German Statistical office, German Bundesbank, Meltzer (2003), and author’s calculations.

Notes: The table shows the misrepresentation index defined in chart 3 under different assumption regarding the behavior of the Board. Board votes with region refers to figures resulting under the assumption made in chart 3, that is, the weight that the Board attaches to developments in each region is strictly proportional to the regions’ relative economic size. Board does not vote with region assumes that Board votes are neutral with regard to regions. Board without voting rights ignores the Board’s votes altogether, computing the regions’ voting rights as a share of regional votes only. Bundesbank data refers to 1992, ECB and Fed data to 2001. There is little change in the results if instead 2004 data is used.

Finally, chart 3 clearly identifies the ECB as an extreme case: with the entry of Greece in 2001, the misrepresentation indicator for the ECB’ Governing Council reached values about seven times higher than for the Fed’s FOMC or the Bundesbank’s Zentralbankrat. Without reform, EMU enlargement could lead to even wider gaps between economic and political weights by the 2010s. In the envisaged EMU-24 scenario, the misrepresentation index is likely to stay above

³² That is the assumption underlying chart 3 – see above.

³³ In fact, the evolution of the Federal Reserve System was characterized by the struggle between federal (or national) and regional forces from the beginning. For instance, H. B. Joy, Director of the Chicago Fed (quoted in Meltzer (2003, p. 75) exclaimed in 1914: “I have a little feeling – in fact it is growing on me – that the Federal Reserve Board in Washington is inclined toward dominating District Banks.”

pre-enlargement levels despite the 2003 reform and, thus, very high relative to the two other federal central banks.³⁴

Table 3 shows that similar stylized facts emerge under alternative assumptions about the behavior of Board members. In line (1), the table reproduces the misrepresentation index as computed for chart 3 for the ECB, the Fed, and the Bundesbank. The assumption is that the Board votes “with” the regions depending on their relative economic size. Alternatively, we could assume that Board members cast their votes completely independent of regional developments (see line (2) for results) or we could simply ignore Board votes altogether in the computation of the misrepresentation index (see line (3)). As the last two columns in Table 3 reveal, the relative difference between misrepresentation in the ECB on the one hand and Fed and Bundesbank on the other is the largest under assumption (1) and broadly comparable under assumption (2). In these cases, the misrepresentation index within the ECB Governing Board reaches levels that are 5 to 7 times larger. Setting board votes to zero under assumption (3), the relative misrepresentation index for the ECB is lower, but at about 3 times the level of today’s Fed and Bundesbank it still qualifies as extreme.³⁵

If the history of the Fed and Bundesbank is any guide, the stark gap between regional representation in the ECB’s Governing Board and relative economic size will (and perhaps should) not last. As chart 3 illustrates, both federal central bank systems started at levels of misrepresentation comparable to the ECB today, but then worked systematically to reduce the gap between representation and size – not least to avoid some of the problems identified earlier. For instance, for Meltzer (2003) the relatively weak role of the Board pre-1935 within the Fed’s monetary policy committee and the continuous struggle between various regional and federal interests were among the key reasons for what many have qualified as a dismal performance of U.S. monetary policy in the 1920s and 1930s.³⁶ And the Bundesbank (1992) stressed that the 1992 redistricting ended a period of strong (and not welcome) differences in terms of size and economic significance.³⁷

³⁴ In a larger EMU with 27 members that included, in addition, the current opt-outs UK, Sweden, and Denmark, the index *after* reform could end up somewhat below the pre-enlargement level. See Berger (2002, Appendix).

³⁵ The type of index (e.g., quadratic rather than absolute) may influence the measured distance between institutions as well. However, the fact that the ECB comes out at the higher end compared to both Fed and Bundesbank is independent of the particular index selected.

³⁶ Based on Metzger’s (2003) detailed account, this includes tensions between different regions regarding their differing representation in the FOMC and its predecessors. For an assessment of the Fed’s performance see, famously, Friedman and Schwartz (1963) and Eichengreen (1992).

³⁷ The Bundesbank had inherited these differences from the Bank Deutscher Länder, its predecessor set up under Allied government in the late 1940s. In 1957, German law

3. An Application to the Eurosystem

3.1 Taking Stock: Where Does the ECB Stand Compared to the Benchmark?

The discussion in section 2 establishes certain benchmarks (however crude) that help us to broadly characterize efficient central bank design. First, the *optimal size* of a monetary policy committee should be a moderately large number. There is theoretical and experimental evidence implying that single-person committees are not efficient, but decision-making costs are likely to be convex in the number of committee members. This suggests that the optimally sized monetary policy committee is larger than one but not too large. Taking a cue from the (unconditional) average of central bank governing bodies, a reasonable upper bound seems to be around 10 for centralized central banks and around 20 for federal central bank systems, which the latter number backed by a significantly smaller number of examples. Taking the federal underpinnings of the Eurosystem as given, the relevant upper bound for the ECB's Governing Board would be around 20. The arguments regarding the *optimal degree of centralization* (i.e. ratio between Board and regional representatives) are involved, but, in general, theory suggests striking a balance between regional (or sectoral) and centralized components. For instance, one advantage of a high vote share for the centrally appointed Board is that it may help ensuring the area-wide perspective of monetary policy; disadvantages include possible limits to the central bank's factual independence from the political center and reduced access to regional information. Empirically, however, perhaps reflecting a higher degree of political and economic heterogeneity, it is mostly the federal central bank systems that are characterized by an interior solution. The majority of monetary policy committees are fully centralized. The share allocated to regional representatives in the Bundesbank and Fed systems is in the 40–50 percent range. Finally, given a share of regional representation, the *optimal degree of representation* of relative economic size is an issue. Balancing the trade-off, theory suggests that neither “one region, one vote” nor voting-rights fully attuned to, say, GDP shares may be optimal. More equal voting rights allow moderating policy regional preference shocks, but, at the same time, could lead to regional interests dominating aggregate monetary policy. This qualitative result is broadly in line with the fact that both Bundesbank and Fed show a non-zero degree of misrepresentation – but their example (both significantly reduced the level of misrepresentation over time) also suggest that much higher degrees may be too extreme.

makers, while debating problems associated with this setup, had refrained from redistricting. See Bundesbank (1992).

At present, the ECB looks broadly in line with two out of three benchmarks. With currently 18 members, the ECB's Governing Council is about en par with the pre-1999 Zentralbankrat and the number of participating (if not voting) FOMC members. Of course, the Governing Council is much larger than the average central bank decision-making body, but so are the two other federal monetary policy committees. Looking at centralization, the ECB stands out somewhat more. At about 66%, the vote share commanded by regional representatives in the Governing Council clearly exceeds the ones in Bundesbank and Federal Reserve. The most striking difference between these three banks occurs regarding the representation-benchmark, however. As elaborated earlier, the degree of misrepresentation of economic size by regional voting rights is a stunning 3 to 7 times larger than in Fed or Bundesbank, depending on the assumptions made concerning the voting behavior of Board members (see table 3). In other words, the "one country, one vote" principle currently enforced within the Governing Council renders the ECB an extreme case – arguably, with possible consequences for a balanced representation of the euro area.

Euro area enlargement is set to further increase the distance to the benchmark. As discussed in section 2, in a hypothetical EMU with 24 members (including the ten recent EU entrants, as well as Bulgaria and Rumania) without reform, the size of the ECB Governing Council (30 members), the share of regional voting rights (80%), and the degree of misrepresentation (even larger than today – see chart 3) within the Eurosystem would by far exceed the levels present in the pre-1999 Bundesbank or today's Federal Reserve System.

The 2003 reform of the ECB statute will moderate but not reverse the impact of enlargement. First, the reform will limit the number of voting members to 15 (out of 24) national central bank representatives and six Board members – even though all 30 might participate in Governing Board meetings. Second, the reform will moderate the decline in the degree of centralization, with regional representatives holding about 70% of voting rights (but about 80% of seats) in the Governing Council. Finally, the introduction of the asymmetric rotation system will reduce the degree of misrepresentation in the EMU-24 scenario to levels only moderately higher than at present. Clearly, however, while the 2003 reform works in the right direction, it will only partially compensate the effects of enlargement (at least in the scenario considered here), leaving the ECB farther away from the benchmark along all three dimension than already today. There is, in short, room for improvement.

3.2 Principle Alternatives for Further ECB Reform

The book on ECB reform might not be closed. Even though, as Servais (2006, in this volume) reports, the 2003 ECB reform has been ratified by all member countries and is scheduled to be implemented in two stages as EMU membership

increases (ECB 2003), some open issues remain and are likely to require further attention. For instance, the particularities of the asymmetric rotation scheme imply an unintended discontinuity in the difference between the voting frequencies of large and medium-sized countries in the Governing Council when EMU membership increases from 18 to 19.³⁸ And, more generally, the introduction of new members to the euro area might lead to additional debates regarding, among other things, the way member countries are size-ranked and allocated rotation frequencies. Finally, looking back at the dynamics of central bank design in the U.S.A. and Germany, there is little reason to expect that any central bank statute is cast in stone – especially when potential inefficiencies are looming.

What are options for (further) ECB reform and how do they compare against the benchmarks discussed above? Table 4 gives a brief overview over some of the possibilities.³⁹

One option would be to substitute the planned rotation scheme by alternative setups that aim at reducing the mismatch between political and economic weights of regional governors in the Governing Council. For instance, *IMF-style representation* would have economically equal-sized groups of countries be represented by one governor in the Governing Council. While this arrangement would reduce the de jure-size of the decision-making committee, it would not necessarily reduce decision making costs. This is because, if the mandates of group representatives were restricted, regional governors will indirectly participate in decision-making process at the group level. Moreover, even if the overall number of groups was roughly in line with today's setup (i.e., twelve), the resulting degree of centralization within the Governing Board would remain low.

³⁸ At this point, the difference in voting frequency drops from 23 percentage points to 1, but increases again to 7 and 11 percentage points with 20 and 21 members (see ECB 2003). One solution would be to force countries to join EMU in groups rather than individually.

³⁹ This discussion mirrors, in part, the debate on the 2003 ECB reform. For an overview see, among others Berger et al. (2004), de Haan et al. (2004) and the literature quoted therein.

Table 4: Alternative ECB Reform Scenarios

<i>Alternative scenarios</i>	<i>Size</i>	<i>Centralization</i>	<i>Representation</i>	<i>Plausible?</i>
(1) Substitute rotation:				
(a) IMF-style representation: Equal-sized groups of CBs with restricted mandate	Very large (de facto)	Low	Close(r) to proportional	Unlikely, at least de jure
(b) BuBa-style redistricting: Redistricted regional CBs of similar economic size	Possibly optimal	Low	Close(r) to proportional	Unlikely, at least de jure, in the short-run
(c) EU-style weighted voting: Size-weighted governor votes, all participate	Very large (de facto)	Low	Proportional	Unlikely
(2) Move to full centralization: Decision power rests with Board alone	Small	Very high	Proportional via Board	Unlikely
(3) Fine-tune reform: More asymmetric rotation, larger Board, fewer governors	Very large (de facto)	Optimal	Close(r) to proportional	Perhaps

Bundesbank-style redistricting of national central bank regions to create districts of more equal economic size, another principle substitute for rotation, has the potential to help reducing decision-making costs compared to the representation scheme.⁴⁰ However, to avoid the problem of a simple reallocation of decision-making costs to the regional level, the “one region (or country), one vote” principle would have to be given up – that is, representatives of countries forced into one district could not be allowed to determine the behavior of the district’s representative in the Governing Board. Similar to representation, the degree of centralization resulting from redistricting depends on the resulting number of districts. *EU-style weighted voting*, too, has the potential to reduce misrepresentation of economic size. Weighting the votes of Governing Council

⁴⁰ If the number of districts was close to today’s EMU membership, the overall size of the Governing Council would remain on today’s level and, thus, broadly in line with the benchmark discussed in section 2.1.

members would all but guarantee that any formal decision represents the economic interest of the euro area. As with representation, however, decision making costs are likely to remain high, if actual decision-making continued to involve elements of the consensus approach. Moreover, absent a simultaneous increase in the number of voting Board members, the degree of centralization would remain low.

A second principle option, popular with many observers prior to the 2003 ECB reform, remains *full centralization*. Bringing the ECB to the main stream of central bank design would require giving up the existing federal structure, which would constitute an even more radical departure from the status quo than substituting the envisaged rotation scheme. The advantages of a fully centralized solution include the likely absence of a regional bias in decision-making and low decision-making costs. A possible disadvantage (not captured in table 4, but highlighted in section 2.2) could be a reduction in factual independence due to the absence of checks and balances.

Perhaps the greatest problem with the reform scenarios discussed so far is that their chances of being implemented are, at best, modest. This is particularly true for the centralization option, which runs against the organizational principle underlying most other European institutions and would require EMU member countries giving up even the last iota of influence on ECB policy after having given up monetary sovereignty for a seat in the Governing Council.⁴¹ Differentiating between schemes to substitute rotation, weighted voting is perhaps the least plausible option because it does achieve little more than the envisaged rotation system, and rotation is seen as more compatible (at least in formal terms) with the idea that each member casts “one vote” (ECB 2003). In comparison, redistricting and representation seem somewhat more likely to be implemented – if not formally, than perhaps on a factual basis. Redistricting could be a natural longer-run solution to the strains the ever increasing demands of full-scale membership in the Eurosystem put on smaller member countries.⁴² Similar forces could lead to the factual introduction of elements of representation within the envisaged rotation scheme (for instance, by smaller countries collectively organizing meeting-preparation or even voting).

The most likely further reform effort, however, is probably a *fine-tuning of the rotation scheme* setup – and this might not be a bad thing. This could take the form of a reduction of the regional component through a decrease in the governors’ vote share in favor of the Board and a more asymmetric allocation of voting rights among regional representatives (either by changing the allocation of votes to country groups or by increasing the number of groups) to reduce misrepresentation.

⁴¹ Berger et. al. (2004) make a similar point.

⁴² For instance, Lindner (2006, in this volume) reports that between 1996 and 2003 the number of required trips of Oesterreichische Nationalbank staff to Frankfurt has more than doubled to more than 600 a year.

A further reduction in the number of Governing Council seats in an attempt to limit decision-making costs would also be conceivable, but, as with representation and weighted-voting, the impact on actual decision-making costs would depend on the Governing Council's willingness to enforce decision-making by vote and forgo consensus-based practices involving all members. Nevertheless, fine-tuning may have the potential to bring the ECB closer to the benchmark at least in two out of three areas (i.e., centralization and representation). In that sense, the most likely approach to further ECB reform might very well be among the more promising ones in efficiency terms.

4. Concluding Remarks

The organizational underpinnings of monetary policy-making tend to change slowly, but they do change – and often for good reasons. Like the U.S. Fed in the 1930s and the German Bundesbank in the 1990s, the European Central Bank has recently adjusted the design of its monetary policy committee. In case of the ECB, these changes were pre-emptive, anticipating the enlargement of the European Economic and Monetary Union, the Bundesbank reacted to German unification, and the reforms of the FOMC reflected, in part, what many considered a less-than-optimal performance of the Fed during the Great Depression. In all cases, however, the ultimate goal of reform was ensuring the efficiency of decision-making.

But what exactly should we be looking for in optimal central bank design? The present paper highlights three basic topics: the question of how many people should be responsible for monetary policy decision; the issue of how much weight should be given to central and regional representation in the monetary policy committee; and the problem of identifying the degree to which regions should be represented in such a committee based to their economic weight. In addition to being at the core of a still growing literature on optimal central bank design, these topics were also at the center of debate when the ECB proposed to change its statute in 2003.

Combining theoretical arguments with empirical evidence on the actual structure of central banks, a benchmark (however rough) for optimal central bank design emerges. (i) Regarding size, there is theoretical and experimental evidence suggesting that single-person committees are not efficient, but decision-making costs are likely to be convex in committee members. Based on the (unconditional) average of central bank governing bodies, a reasonable upper bound for committee size seems to be around 20 for federal central bank systems such as the ECB. (ii) The trade-off behind the optimal degree of centralization balances, among other things, the wish to ensure an area-wide perspective with possible repercussions for central bank independence and better access to regional information. Empirically, a strong regional presence is the exception rather than the rule, and even within federal central bank systems such as the Bundesbank and Fed, regional

representatives do not hold much more than 50% of the available votes. (iii) As to the optimal degree of representation of relative economic size, theory suggests that equal voting rights might help moderating regional preference shocks, but at the possible price of allowing regional interests to dominate monetary policy. That both the Bundesbank and Fed significantly reduced the gap between regional voting rights and relative economic size over time suggests that much higher degrees may be too extreme.

While there are some obvious caveats to this kind of reasoning, applying the resulting benchmarks to the ECB can be instructive.⁴³ The paper finds the current design of the ECB to be broadly in line with recommendations, with the possible exception of a relative high mismatch between relative economic size and regional voting rights in the Governing Council. However, the picture changes once EMU enlargement is taken into account. Even when factoring in the effects of the 2003 ECB reform – the reform establishes an upper limit for committee size and introduces an asymmetric rotation (and this voting) scheme that favors larger regions in case of enlargement – the ECB might be significantly “off” the benchmark once EMU membership increases. For instance, in a scenario with 24 euro area members (including the new EU entrants as well as Bulgaria and Rumania), up to 30 decision-makers might participate in Governing Board meetings, the voting share of regional representatives would reach about 70%, and the degree of misrepresentation of relative economic size will be at least three times the level at the Fed or the pre-1999 Bundesbank.

Against this background, a refinement of the planned asymmetric rotation scheme would have advantages. Such fine-tuning could reduce the relative vote share of regional (i.e., national) governors in favor of the Board and, in addition, adjust regional voting rights to better reflect relative economic size and reduce misrepresentation. In addition, a further reduction in the number of Governing Council seats could help to limit decision-making costs, even though the effect of such a measure would, in part, depend on the ECB’s willingness to forgo consensus-based practices involving all members present. An added advantage of fine-tuning the current design of the ECB’s monetary policy committee along these lines would be that it follows the pattern of the 2003 reform. This might enhance its feasibility in political terms compared to more radical proposals such as UK-style full centralization of euro area monetary policy.

⁴³ First, these benchmarks are based on theoretical arguments that are, more often than not, qualitative and, therefore, hard to translate into hands-on guidelines for institutional design. In addition, where empirical results have been used, these stylized facts are descriptive rather than based on an explicit analysis of determinants of central-banking success.

References

- Alesina, Alberto and Enrico Spolaore (2003), *The Size of Nations*, The MIT Press: Cambridge, MA.
- Aksoy, Yunus, Paul de Grauwe, and Hans Dewachter (2002), Do Asymmetries Matter for European Monetary Policy? *European Economic Review*, 46(3), 443–69.
- Baldwin, Richard (2001), The ECB’s Number Problems, *Financial Times* (London), December 4.
- Baldwin, Richard, Erik Bergl of, Francesco Giavazzi, and Mika Widgren (2001), *Preparing the ECB for Enlargement*, CEPR Policy Paper, 6, CEPR: London.
- Barber, T., (2001), Casting Light on the ECB, *Financial Times Online* (London), September 6.
- Benigno, Pierpaolo (2004), Optimal Monetary Policy in a Currency Area, *Journal of International Economics*, 63(2), 293–320.
- Berger, Helge (1997), The Bundesbank’s Path to Independence. Evidence from the 1950’s, *Public Choice*, 93, 427–53.
- Berger, Helge (2002), The ECB and Euro-Area Enlargement, *IMF Working Paper*, 02/175.
- Berger, Helge and Jakob de Haan (2002), Are Small Countries too Powerful within the ECB? *Atlantic Economic Journal*, 30 (3), 1–20.
- Berger, Helge and Till M uller (2004). How Should Large and Small Countries Be Represented in a Currency Union? *CESifo Working Paper*, 1344.
- Berger, Helge, Jakob de Haan and Robert Inklaar (2004), Restructuring the ECB, in: Helge Berger and Thomas Moutos (eds.), *Managing EU Enlargement*, Cambridge: The MIT Press, 29–66.
- Berger, Helge, Sylvester Eijffinger and Jakob de Haan (2001), Central Bank Independence: An Update of Theory and Evidence, *Journal of Economic Surveys*, 2001, 15(1), pp. 3–40.
- Bindseil, Ulrich (2001), A Coalition-Form Analysis of the “One Country-One Vote” Rule in the Governing Council of the European Central Bank, *International Economic Journal*, 15(1), 141–64.
- Blinder, Alan and John Morgan (2005), Are Two Heads Better Than One? Monetary Policy by Committee, *Journal of Money, Credit and Banking*, 37(5), 798–811.
- Blinder, Alan and Charles Wyplosz (2004), Central Bank Talk: Committee Structure and Communication Policy, *Mimeo*, Princeton and Graduate Institute of International Studies.
- Bullard, James and Christopher Waller (2004), Central Bank Design in General Equilibrium, *Journal of Money, Credit, and Banking*, 36(1), 95–113.

- Bundesbank (1992), Restructuring the Bundesbank, *Monthly Report*, August, 48–53.
- Chappell, Henry, Rob Roy McGregor, and Todd Vermilyea (2005), *Committee Decisions on Monetary Policy, Evidence from Historical Records of the Federal Open Market Committee*, The MIT Press: Cambridge, MA.
- Dvorsky, Sandra and Isabella Lindner (2003), Institutionelle Entwicklungen im ESZB. Anpassung der Stimmrechtsmodalitäten im EZB-Rat, *Österreichische Nationalbank, Berichte und Studien*, 2, 144–59.
- Eichengreen, Barry (1992), Designing a Central bank for Europe: A Cautionary Tale from the Early Years of the Federal Reserve System”, in: Matthew Canzoneri, Vittorio Grilli, and Paul Masson (eds.), *Establishing a Central Bank: Issues in Europe and Lessons from the U.S.*, Cambridge University Press, Cambridge, 13–40.
- European Central Bank (ECB) (1999), The Institutional Framework of the European System of Central Banks, *Monthly Bulletin*, July, 55–63.
- European Central Bank (ECB) (2003), The Adjustment of Voting Modalities in the Governing Council, *Monthly Bulletin*, May, 73–83.
- European Union (1997), Consolidated Version of the Treaty Establishing the European Community, Official Journal of the European Communities, C 340, November 10.
- Fahrholz, Christian and Philipp Mohl (2004), EMU-Enlargement and the Reshaping of Decision-Making within the ECB Governing Council: A Voting-Power Analysis, *Ezoneplus Working Paper*, 23.
- Faust, Jon and Dale Henderson (2004), Is Inflation Targeting Best-Practice Monetary Policy? *Federal Reserve Bank of St. Louis Review*, 86(4), 117–43.
- Fitoussi, Jean-Paul and Jerome Creel (2002), *How To Reform the European Central Bank*, CER: London.
- Frey, Rainer (2004), Welfare Implications of the Design of a Currency Union in Case of Member Countries of Different Sizes and Output Persistence, Deutsche Bundesbank Discussion Paper, Series 1, 15/2004 (forthcoming in: *Kredit und Kapital*).
- Fry, Maxwell, Deanne Julius, Lavan Mahadewa, Sandra Roger and Gabriel Sterne (2000), Key Issues in the Choice of Monetary Policy Framework, in: Lavan Mahadeva and Gabriel Sterne (eds), *Monetary Frameworks in a Global Context*, Routledge: London, 1–216.
- Friedman, Milton and Anna Schwartz (1963), *A Monetary History of the United States 1967–1960*, Princeton University Press: Princeton.
- Gerlach-Kristen, Petra (2002), Monetary Policy Committees and Interest-Rate Setting, *European Economic Review*, forthcoming.
- Gerling, Kerstin, Hans Peter Grüner, Alexandra Kiel, and Elisabeth Schulte (2003), Information Acquisition and Decision Making in Committees: A Survey, *ECB Working Paper*, 256.

- Gersbach, Hans and Bernhard Pacht (2004), Flexible Rules for Central Banks, *Mimeo*, University of Heidelberg.
- Gersbach, Hans and Volker Hahn (2001), Voting Transparency and Conflicting Interests in Central-Bank Councils, *Mimeo*, University of Heidelberg.
- Giannone, Domenico and Lucrezia Reichlin (2005), Trends and Cycles in the Euro Area: How Much Heterogeneity and Should We Worry About It? *Mimeo*, Université Libre de Bruxelles.
- Goodfriend, Marvin (2000), The Role of a Regional Bank in a System of Central Banks, *Federal Reserve Bank of Richmond Economic Quarterly*, Winter, 7–25.
- Gros, Daniel (Chairman) and others (2002), The Euro at 25, Special Report of the CEPS Macroeconomic Policy Group, CEPS: Brussels.
- Gros, Daniel and Carsten Hefeker (2002), One Size Must Fit All: National Divergences in a Monetary Union, *German Economic Review*, 3 (3), 247–62.
- Haan, Jakob de, Helge Berger and Robert Inklaar (2004), Is the ECB Too Decentralized?, in: Hans-Werner Sinn, Mika Widgren, and Marko Köthenburger (eds.), *European Monetary Integration*, Cambridge: The MIT Press, 71–97.
- Hagen, Jürgen von and Matthias Brückner (2001), Monetary Policy in Unknown Territory, The European Central Bank in the Early Years, *ZEI Discussion Paper*, B18.
- Hagen, Jürgen von and Ralph Süppel (1994), Central Bank Constitutions for Federal Monetary Unions, *European Economic Review*, 38, 774–82.
- Hallerberg, Mark (2002) Veto Players and Monetary Commitment Technologies. *International Organization*, 56 (4), 775–802.
- Havrilevsky, T. and Gildea J. (1995), The Bias of Federal Reserve Presidents, *Economic Inquiry*, 33, 274–284.
- Hefeker, Carsten (2002), Monetary Policy in a Union of 27: Enlargement and Reform Options, *Intereconomics*, November/December, 315–20.
- Hefeker, Carsten (2003), Federal Monetary Policy, *Scandinavian Journal of Economics*, 105, 641–59.
- Heinemann, Friedrich and Felix Huefner (2004), Is the View from the Eurotower Purely European? National Divergence and ECB Interest Rate Policy, *Scottish Journal of Political Economy*, 51(4), 544–58.
- Heisenberg, Dorte (2003), Cutting the bank Down to Size: Efficient and Legitimate Decision-Making in the European Central Bank After Enlargement, *Journal of Common Market Studies*, 41(3), 397–420.
- Lindner, Axel (2000), Long-Term Appointment of Central Bankers: Cost and Benefits, *European Journal of Political Economy*, 16, 639–54.
- Lohmann, Susanne (1997), Partisan Control of the Money Supply and Decentralized Appointment Powers, *European Journal of Political Economy*, 13, 225–46.

- Lohmann, Susanne (1998), Federalism and Central Bank Independence: The Politics of German Monetary Policy, *World Politics*, 50, 401–46.
- Lombardelli, Clare, James Proudman, and James Talbot (2005), Committees Versus Individuals: An Experimental Analysis of Monetary Policy Decision Making, *International Journal of Central Banking*, 1(1), 181–205.
- Lybeck, Tonny and JoAnne Morris (2004), Central Bank Governance: A Survey of Boards and Arrangements, *IMF Working Paper*, 04/226.
- Maier, Philipp, Beata Bierut and Robert-Paul Berben (2003), The Role of Regional Information in the Optimal Composition of a Committee, *MEB Discussion Paper (De Nederlandsche Bank)*, 2003–08.
- Meade Ellen and Nathan Sheets (2005), Regional Influences on FOMC Voting Patterns, *Journal of Money, Credit and Banking*, 37(4), 661–677.
- Meade, Ellen (2003), A (Critical) Appraisal of the ECB's Voting Reform, *Intereconomics*, forthcoming.
- Meltzer, Allan (2003), *A History of the Federal Reserve*, Volume I: 1913–1951, The University of Chicago Press: Chicago, IL.
- Moser, Peter (1999), Checks and Balances, and the Supply of Central Bank Independence, *European Economic Review*, 43, 1569–93.
- Rose, Andrew (2005), Size Really Doesn't Matter: In Search of a National Scale Effect, *Mimeo*, University of California, Berkeley.
- The Economist (1998), *Euro Towers or Fawly Towers?*, 31 October, 1998.
- Thygesen, Niels (1989), Decentralization and Accountability within the Central Bank: Any Lessons from the U.S.A. Experience for the Potential organization of a European Central Banking Institution? in: Paul de Grauwe and Theo Peeters (eds.), *The ECU and European Monetary Integration*, MacMillan: London, 91–114.
- Tootell, G. (1991), Regional Conditions and the FOMC Votes of District Presidents, *New England Economic Review*, March-April, 3–16.
- Waller, C. and Carl Walsh (1996), Central Bank Independence, Economic Behavior, and Optimal Term Length, *American Economic Review*, 85(5), 1139–54.

Appendix: A (Brief) Synopsis of the Role of the Board in the Fed's Monetary Policy Committee

Name	Year	Banks	Board	Sum	Share Banks	Comments
Governors Conference	1914	12	5+2	19	100	Board with 5 members from districts (not 2 out of 1), 2 government members (Secretary of the Treasury, Comptroller of the Currency). Law stipulates that <i>authority for open market policy rests solely with regional Federal Reserve Banks</i> , which are more interested in earnings than national monetary policy concerns. As a consequence, the <i>possibility to opt out of coordinated open market policies</i> remains intact (while gradually reduced) until Banking Act of 1935: " <i>local option</i> ".
Committee on Centralized Purchases and Sales	1922	5	5+2	12	100	CCPS coordinates Reserve Bank open market actions, makes suggestions. <i>Fed NY emerges as dominant force</i> , while taking into account the interest of other Federal Reserve Banks – not least to keep the Board at bay. Participation of Reserve Banks in the suggested open market actions remains voluntary, though.
Open Market Investment Committee (1)	1923	5	6+2	13	~90	Agricultural interests gain a seat in the Board. Board forces abolition of CCPS, renaming it OMIC, and trying to put it under Board authority. While the GC rejected this, the <i>Board gained some supervisory power</i> over open market operations. Before that point, such power only existed with regard to discount rate decisions. Still, participation of Reserve Banks in the coordination of open market policy remained voluntary.
Open Market Investment Committee (2)	1928	12	6+2	20	~85	Board succeeded in <i>reducing the power of the FedNY</i> by making the original OMIC responsible to all Federal Reserve Banks; the original OMIC continued as an executive committee.
Open Market Policy Conference	1930	12	6+2	20	~80	Name change mainly the result of a bungled attempt by the <i>Board to gain veto power over open market policy</i> decisions by the Federal reserve banks (similar to discount policy). Little else changed. For instance, the Federal Reserve Banks on Chicago and Boston often abstain from coordinated open market operations. (Benjamin Strong, dominant Governor of the NYFed, died earlier.)
Federal Open Market Committee (1)	1933	12	6+2	20	~70	Similar to OMPC in all but its name (Banking Act of 1933). <i>Board gains some powers</i> of Federal Reserve Banks, including wider supervisory powers on open market operations. However, Federal Reserves still had a "local option". Chicago, for example, made use of this in 1933 (the suggested purchases threatened profits).
Federal Open Market Committee (2)	1935	5	7	12	42	<i>Asymmetric representation scheme</i> for the 5 Reserve Bank seats (1 representative selected each year, no rotation). Board no without ex officio government members, but reduced by 1 to 7.
Federal Open Market Committee (3)	1942	5	7	12	42	<i>Asymmetric rotation scheme</i> for the 5 Reserve Banks. Groups changed from 1935.

Source: Meltzer (2003), Eichengreen (1992).

Documenting FOMC Voting Patterns¹

Ellen E. Meade

American University

D. Nathan Sheets

Federal Reserve System

In this paper, we outline the key features of the Federal Reserve's (Fed) regional voting rotation and present some data that summarize how that rotation system has worked in practice. We do not address directly a number of underlying issues related to the Federal Open Market Committee's (FOMC) voting outcomes, including the potential role or importance of regional considerations in influencing the votes of FOMC members, the factors that drive FOMC dissents more generally, or lessons from the U.S. experience for the optimal design of the European Central Bank's (ECB) voting mechanism as the number of countries in the euro area expands. Nevertheless, our work does bear on such issues to varying degrees, and we provide some thoughts and conjectures about them in the discussion below.

1. Structure of the FOMC

The Fed's key policy-setting body, the Federal Open Market Committee or FOMC, is comprised of 19 members. The composition of the FOMC highlights the dual, public-private nature of the Federal Reserve System. The seven members of the Board of Governors in Washington DC are members of the FOMC. The Board members are nominated by the U.S. President and confirmed by the Senate, and they are public officials in every respect. The FOMC also includes the presidents of the twelve regional Federal Reserve Banks. The Reserve Banks are sprinkled through the country from Boston to San Francisco. The Reserve Bank Presidents are appointed by each bank's Board of Directors, with the approval of the Board of Governors in Washington.² The U.S. President and Congress have no formal role

¹ The views expressed in this paper are solely the responsibility of the authors and should not be interpreted as reflecting the views of the Board of Governors of the Federal Reserve System or of any other person associated with the Federal Reserve System. The authors thank Nathan Montgomery for excellent research support.

² Each Federal Reserve Bank has a Board of Directors comprised of nine members. Six of these members are elected by the member commercial banks in each Federal Reserve

in the selection of the Reserve Bank Presidents. As a general statement, the responsibilities and functions of the Bank Presidents have both public sector and private sector elements.

There are twelve votes cast at each FOMC meeting. The seven members of the Board of Governors vote at every FOMC meeting. The voting prerogatives of the Reserve Bank Presidents are determined by a 1942 amendment to the Federal Reserve Act. The President of the Federal Reserve Bank of New York votes at each FOMC meeting and has always been elected the Vice Chairman of the FOMC. In these important respects, the Federal Reserve Bank of New York has been the most influential of the regional banks.³ The Presidents of the other Reserve Banks cast the four remaining votes according to the following rotation:

- The first of these votes rotates annually between Chicago and Cleveland. The designers of the Fed's voting system apparently wanted to balance concerns about the country's financial interests, which they thought would particularly influence the views of the President of the New York Fed, with concerns about the country's industrial interests, which they expected would particularly influence the thinking of the Reserve Bank Presidents from Chicago and Cleveland.
- The second vote rotates annually between three Eastern regions - Boston, Philadelphia, and Richmond. Thus, these banks vote in one out of every three years.
- The third vote rotates annually between Atlanta, Dallas, and St. Louis.
- The fourth vote rotates annually between Kansas City, Minneapolis, and San Francisco.

It should be noted that non-voting members of the FOMC participate fully in meetings – reporting on economic developments in their respective regions and

district, while the remaining three Directors (including the Chairman and the Vice Chairman) are appointed by the Board of Governors. For further details see *The Federal Reserve System Purposes and Functions* (2005).

³In explaining the rationale for allowing the President of the Federal Reserve Bank of New York to vote at every FOMC meeting, the *Federal Reserve Bulletin* (1942) made the following observations: “The Federal Reserve Bank of New York occupies a unique position with respect to the Federal Reserve System, the Treasury, and the banking system of the country. Its resources total approximately 40% of the aggregate of the twelve Federal Reserve Banks. It is located at the central money market and at the principal market for Government securities; its operations as fiscal agent for the United States and its transactions with foreign governments, foreign central banks and bankers, as well as its operations in foreign exchange, are in far greater volume than those of any other Federal Reserve Bank. It is clearly in the public interest that the Federal Open Market Committee be given at all times the benefit of counsel of the Federal Reserve Bank which is in constant touch with the domestic and international money markets and has had long experience in these fields.”

sharing their views regarding the national economy and the appropriate stance of policy—they simply do not cast a vote at the end of the meeting.⁴

2. Regional Identity of FOMC Members

It is relatively straight forward to ascribe regional identity to the Reserve Bank Presidents; they live, work, and interact with people in their regions. And, as part of the FOMC process, they typically monitor and report on developments in their regions. Under the Federal Reserve Act, the Board members also have regional identity. No two Board members can come from the same Federal Reserve district. This requirement is treated somewhat flexibly, however. For example, residency requirements surfaced in the 1991 Senate hearings for Lawrence Lindsey's nomination to serve on the Board. The following is an excerpt from those hearings:⁵

Senator Sarbanes: “All right. Now, for what geographic region are you being appointed to the Board to represent?”

Mr. Lindsey: “I’m representing the Richmond Federal Reserve district.”

Senator Sarbanes: “What’s your connection with the Richmond Federal Reserve district?”

Mr. Lindsey: “I own a house in Virginia. It’s the only house that my wife and I own. I pay income taxes there, personal property taxes there, vote there. We’ve actually spent half our married life there, in two stints.”

Senator Sarbanes: “How much of your life have you spent there?”

Mr. Lindsey: “Five years.”

Senator Sarbanes: “Out of how many?”

Mr. Lindsey: “Thirty-six.”

⁴ Meade (2005) reviews FOMC transcripts and compiles explicit indications of policy preferences for both voting and non-voting FOMC members. She finds that over the 1989-97 period, non-voting Bank Presidents were significantly more likely than voting Bank Presidents to voice disagreement with the Chairman’s interest rate proposal.

⁵ See Hearings, pp. 45-46.

Senator Sarbanes: “Well. Half of your married life is not highly relevant to the nexus with the Richmond Reserve district, is it?”

Mr. Lindsey: “Well, Senator, my –”

Senator Sarbanes: “Why do you think that requirement is in the law, in the Federal Reserve law? Why was it put there? Why do we have a geographical requirement? ... Wasn’t one intent at least to get people from different regions of the country who participated in the economic life of their region to sit on the Federal Reserve Board making nationwide monetary policy? ... I don’t understand how you under any stretch of the imagination would meet that criteria for the Richmond Reserve district.”

Despite these objections, Lindsey was subsequently confirmed as a Board member. The residency requirement has been treated flexibly for more recent appointments as well. For example, Edward Gramlich, who lived for many years in Ann Arbor, Michigan and returned there last August after he resigned from the Board, was appointed as representing the Richmond district; his link to the Richmond district was that he had worked in Washington DC (part of the Richmond district) early in his career.⁶ Donald Kohn who has lived in the Richmond district for decades, was appointed from the Kansas City district, justified by the fact that he began his professional career as an economist at the Federal Reserve Bank of Kansas City. In contrast, other Board members, including Martha Seger, John LaWare, and Laurence Meyer had comparatively deep roots in their regions.

The clear conclusion is that the nature and extent of regional affiliations differ significantly across Board members. Some have strong connections to their regions, while others do not. For that matter, the same may be said for the Reserve Bank Presidents. Some have spent many years working in their regions (e.g., Alfred Broaddus, Anthony Santomero, and Janet Yellen), while others are appointed as geographic outsiders (e.g., William Poole and Timothy Geithner). As such, the regional identity of Federal Reserve policymakers in many cases is much less clear than is the case, for instance, with the ECB.

For the sake of our analysis, we assign regional identity to Fed policymakers – both Board member and Bank Presidents. We then examine whether there are any systematic differences in the voting behavior of FOMC members from different districts. As we discuss below, one noteworthy feature of the Federal Reserve System is that the Chairman has often had roots in the New York district.

⁶ Biographical information for FOMC members comes from Bloomberg.

3. Distribution of FOMC Votes

Table 1: Size of Federal Reserve Districts

	Assets (1990)		Population (1990)		Real GDP (1990)	
	USD billions	%	Millions	%	USD billions*	%
Boston	21.5	6.6	12.4	5.0	334	5.6
New York	125.2	38.2	24.1	9.7	718	11.9
Philadelphia	9.3	2.8	11.5	4.6	280	4.6
Cleveland	19.3	5.9	16.1	6.5	352	5.8
Richmond	22.3	6.8	23.3	9.4	580	9.6
Atlanta	16.3	5.0	31.8	12.8	668	11.1
Chicago	40.9	12.5	30.6	12.3	695	11.5
St. Louis	9.2	2.8	12.5	5.0	253	4.2
Minneapolis	5.5	1.7	7.6	3.1	168	2.8
Kansas City	9.7	3.0	13.5	5.5	294	4.9
Dallas	14.5	4.4	18.5	7.4	436	7.2
San Francisco	33.7	10.3	46.7	18.8	1247	20.7
Total	327.6	100.0	248.7	100.0	6024	100.0

Source: Annual Report of the Board of Governors of the Federal Reserve System (1990), Bureau of Economic Analysis (BEA) data and authors' calculations.

* Expressed in 1992 U.S. dollars.

As shown in table 1, there is significant variation in the size of the Federal Reserve districts. (We choose 1990 as our comparison year, since it is near the mid-point of the two samples that we study.) The first two columns of data focus on the assets held by each of the Federal Reserve Banks, sometimes seen as a proxy for the extent of each district's financial development. Three banks hold over 60% of the System's assets, with the New York Fed holding 38.2%, the Chicago Fed holding 12.5%, and the San Francisco Fed holding 10.3%. Population and real GDP are somewhat more evenly distributed, with the San Francisco district at around 20% of both categories, and New York, Richmond, Atlanta, and Chicago all hovering at around 10%. As such, the five largest districts account for 60 to 65% of U.S. population and GDP. Notably, Minneapolis is the smallest district by all three of these measures, with only 1.7% of the System's assets, 3.1% of the U.S. population, and 2.8% of the country's GDP.

*Table 2: Average Votes per FOMC Meeting from 1968 to 2004**

	All Voters	Board	Bank	Total Votes
New York	1.93	0.93	1.00	733
Chicago	1.27	0.79	0.48	485
Richmond	1.20	0.89	0.31	455
Boston	1.05	0.68	0.37	398
Kansas City	1.00	0.63	0.37	380
Dallas	0.98	0.65	0.33	371
Philadelphia	0.95	0.63	0.32	362
San Francisco	0.85	0.54	0.31	324
St. Louis	0.64	0.31	0.33	244
Atlanta	0.60	0.26	0.34	228
Cleveland	0.51	0.00	0.51	195
Minneapolis	0.44	0.12	0.32	170

Source: Authors' calculations.

* Calculated using 380 FOMC meetings, including both scheduled meetings and conference calls.

Table 2 tabulates FOMC votes by region (including both Board members and Reserve Banks Presidents) from 1968 to 2004.⁷ As shown in the first row, the New York district has had far and away the most voting power, casting on average 1.93 votes at each FOMC meetings over this period, for a total of 733 votes. The New York Fed President (or First Vice President) cast a vote at 379 of the 380 meetings,⁸ and a New York Board member voted at 93% of the meetings. Moreover, these voting statistics if anything understate the influence of the New York district in the formulation of monetary policy because three of the Chairmen during this period – William Martin, Arthur Burns, and Alan Greenspan – came

⁷ See also Meade and Sheets (1999).

⁸ If the President of the Federal Reserve Bank of New York cannot attend an FOMC meeting, his vote is cast by the Bank's First Vice President.

from New York. Thus, the person chairing the FOMC meeting represented New York in 279 of the 380 meetings that we consider.⁹

After New York, the regions divide quite neatly into three separate groups. The next group includes Chicago and Richmond, which have each cast on average about 1-1/4 votes at FOMC meetings. The following group includes Boston, Kansas City, Dallas, Philadelphia, and San Francisco. Each of these districts has cast roughly one vote per meeting. Finally, St. Louis, Atlanta, Cleveland, and Minneapolis have had the least voting power, casting only about ½ vote on average per meeting.

There is notable variation in the extent to which the various districts have been represented on the Board. New York and Richmond (the district that includes Washington DC) have been represented by Board members at about 90% of the FOMC meetings. In contrast, Minneapolis has been represented only 12% of the time, and there has not been a Board member from Cleveland in the entire span of our 1968 – 2004 sample.¹⁰

There are clearly some divergences between measures of relative district size – such as financial assets, population, and real GDP – and regional voting power. The most striking divergence (see table 3) is that San Francisco ranks third for assets and first for population and real GDP, but only eighth for voting frequency. Cleveland and Atlanta also seem to be significantly under-represented given measures of their economic mass. In contrast, Philadelphia and Kansas City seem to have had more votes than would be justified on the basis of these criteria. For example, Kansas City is ninth in terms of assets and real GDP and eighth in terms of population, but fifth in terms of voting power.

⁹ In addition, Paul Volcker was serving as President of the New York Fed when he was appointed Federal Reserve Chairman, but Emmett Rice held a seat for New York at that time. Accordingly, during Volcker's tenure as Chairman he represented the Philadelphia district, which encompasses the place where he was born (Cape May, New Jersey).

¹⁰ The last Board member from the Cleveland district was John McKee, who served on the Board from February 1936 through April 1946.

Table 3: Rankings of Federal Reserve Districts

	Votes per Meeting (1968–2004)	Assets (1990)	Population (1990)	Real GDP (1990)
Boston	4	5	10	8
New York	1	1	4	2
Philadelphia	7	10	11	10
Cleveland	11	6	7	7
Richmond	3	4	5	5
Atlanta	10	7	2	4
Chicago	2	2	3	3
St. Louis	9	11	9	11
Minneapolis	12	12	12	12
Kansas City	5	9	8	9
Dallas	6	8	6	6
San Francisco	8	3	1	1

Source: Authors' calculations.

Such observations regarding apparent misalignments between voting shares and measures of relative regional size and significance are not widely recognized. Such observations certainly are not part of public discussions of how the Federal Reserve operates, and they have not really been part of the academic discussion either. This may at root reflect that regardless of the geographical composition of the FOMC, the members are primarily concerned with constructing policy to achieve national objectives; and, for this reason, the regional composition of the FOMC has had little effect on policy and, thus, has not drawn attention.

Along these lines, we emphasize that the Federal Reserve districts do not correspond to any well-delineated political jurisdictions. Many U.S. states are split between two Federal Reserve districts. The average “person on the street” would have little idea which district his home was in.¹¹ For these reasons, regional identity on the FOMC is likely much less pronounced than is the case in Europe for the ECB. If ECB voting structures resulted in the kinds of divergences between relative voting strength and, say, real GDP that have been observed for the FOMC, it would have likely attracted much more attention than has been the case for the United States. For example, if Germany had cast twice as many votes as France (or

¹¹ Gildea (1992) similarly notes that “typically a Federal Reserve district covers several entire states and sections of several other states. The irregular and little known boundaries of these districts may make the economic statistics and political events in these districts less likely to attract day-to-day highly publicized attention from the popular media.”

vice versa) – similar to what has happened with New York and San Francisco – this likely would have drawn public attention and been a subject of discussion.¹²

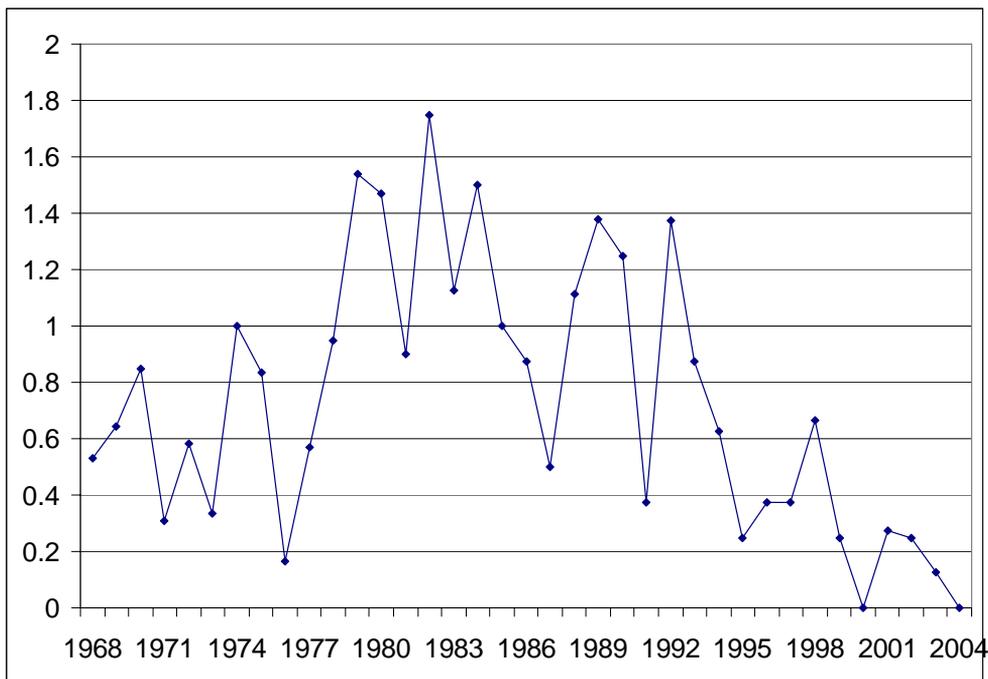
4. FOMC Dissenting Votes

We now turn to a discussion of FOMC dissenting votes. As shown in chart 1, which plots the average number of dissents per meeting for each year from 1968 to 2004, dissents per meeting peaked in the late 1970s and early 1980s, as the FOMC aggressively tightened policy to bring down high inflation. Over the past five years, however, dissents from the majority have been at or near zero. For all intents and purposes, there has been consensus on the FOMC regarding the course of policy. This is remarkable, given that the economy has experienced some sizable shocks and that the global economic environment has been quite challenging. On average over this 36-year period, there has been about three quarters of a dissent per meeting or, alternatively, three dissents for every four meetings.

A discussion of what drives dissents is beyond the scope of this paper. However, we have found in other work that divergent regional performance may be a source of dissents. In particular, when a region's unemployment rate is below the national average, FOMC members from that region (both Board members and Bank Presidents) are more likely to dissent for tighter policy and less likely to dissent for easier policy than would otherwise be the case. By the same token, when a region's unemployment rate is above the national average, FOMC members from that region are more likely to dissent for easier policy and less likely to dissent for tightening.¹³ Of course, there are other factors – including the Chairman's ability to persuade members and form coalitions and the extent of prevailing economic uncertainties – that also play an important role in driving FOMC dissents. (An interesting, albeit somewhat speculative, question is whether FOMC dissents will again rise following the departure of Chairman Greenspan in early 2006.)

¹² This observation is not inconsistent with results shown in Berger (2005) suggesting that a measure of the aggregate mismatch between voting weights and regional GDP shares is greater for the ECB than for the Federal Reserve. First, Berger's calculations assume that Board members have no regional identity and, as such, weight regions according to GDP shares. Given that Board members constitute 7 of the 12 members of the FOMC but only 6 of the 18 members of the ECB Governing Council, this feature of his calculations tends to reduce mismatch for the FOMC relative to the ECB. Second, in the case of the ECB, mismatch has arisen because the central bank governors from large countries and small countries each cast one vote at policy meetings not because one large country has voted significantly more frequently than another large country, an outcome which would be more likely to draw public attention.

¹³ This evidence is outlined in detail in Meade and Sheets (2005).

*Chart 1: Dissents per Meeting**

* Number of dissents in all meetings in a given year divided by the number of meetings in that year.

Source: Authors' calculations.

As shown in table 4, over our sample period dissents have totaled 7.1% of FOMC votes. Board members have dissented 6.3% of the time, while Bank Presidents have dissented more frequently, 8% of the time.¹⁴ One hypothesis to explain the lower dissent rate for Board members is that working in the same building with the Chairman and sharing staff with the Chairman, Board members are more likely than Bank Presidents to see the world in the same way that the Chairman does. It is also possible that, given this proximity, the Chairman has more opportunities to influence the thinking of the Board members.

¹⁴ The dissent probabilities reported in Table 4 exclude votes by the Chairman. A feature of FOMC meetings is that the Chairman frames the question on which votes are cast and, as such, the Chairman does not dissent. If votes by the Chairman are included in the tally (the last line of Table 4), the dissent frequency for all voters falls to 6.5%, and the dissent rate for Board members declines to 5.4%.

*Table 4: Frequency of Dissent from 1968 to 2004**

	All Voters (%)	Board (%)	Bank (%)	Tot. Dissents
Cleveland	12.3	.....	12.3	24
St. Louis	11.5	1.7	20.8	28
Boston	10.6	12.8	6.4	42
Minneapolis	7.6	4.3	8.9	13
San Francisco	7.0	8.3	6.4	21
Chicago	7.0	11.3	0.0	34
Richmond	6.4	3.6	14.4	29
Dallas	6.2	4.5	9.7	23
Kansas City	6.1	5.4	7.2	23
New York	5.7	6.5	5.5	26
Atlanta	5.3	1.0	8.4	12
Philadelphia	2.4	1.8	3.3	7
Total	7.1	6.3	8.0	282
<i>Total including Chairmen</i>	<i>6.5</i>	<i>5.4</i>	<i>8.0</i>	<i>282</i>

* Dissents as share of each district's votes; excludes votes by Chairmen.

Source: Authors' calculations.

Among the regional banks, there have been striking differences in dissent frequency. The Presidents of the St. Louis Bank have been the most frequent dissenters by far, disagreeing with the majority 20.8% of time. Dissent probabilities for Richmond and Cleveland Fed Presidents have also been high, 14.4% and 12.3%, respectively. Previous researchers have linked the frequent dissents of the St. Louis and Cleveland Reserve Bank Presidents to the monetarist views held by some presidents of those banks.¹⁵ On the other end of the spectrum, the President of the Chicago Fed has not dissented even once since 1968, and the President of the Philadelphia Fed has only dissented 3.3% of the time.

For the Board members, Boston and Chicago have been the most frequent dissenters, voting "no" in well over 10% of their votes. In contrast, dissents for the Board members from several other districts – including St. Louis, Atlanta, and Philadelphia – have been very rare, in the 1 to 2% range.

¹⁵ See, for example, Gildea (1990).

5. Direction of Dissenting Votes

We now turn to the direction of dissent; that is, whether the dissenting vote was in favor of tighter policy or looser policy than that preferred by the FOMC majority. We have collected information on the direction of dissents from 1978 to 2004, a somewhat shorter sample than in the previous discussion. This sample captures 249 meetings (including both scheduled meetings and conference calls), 2,788 FOMC votes, and 206 dissents.

Table 5: Direction of Dissents from 1978 to 2004

	Tightening Dissents		Easing Dissents	
	Number	Share*	Number	Share*
Atlanta	7	1.00	0	0.00
Boston	32	0.94	2	0.06
Minneapolis	10	0.91	1	0.09
Cleveland	19	0.90	2	0.10
Kansas City	17	0.89	2	0.11
St. Louis	12	0.80	3	0.20
Dallas	13	0.76	4	0.24
Richmond	19	0.66	10	0.34
New York	5	0.45	6	0.55
San Francisco	3	0.30	7	0.70
Philadelphia	0	0.00	1	1.00
Chicago	0	0.00	31	1.00
Total	137	0.67	69	0.33

Source: Authors' calculations.

* *Dissents in favor of tightening/easing as a share of each district's total dissents.*

As shown in table 5, two thirds of total dissents – including both Board members and Bank Presidents – were in favor of tighter policy, and only one third were in favor of easier policy. In other words, dissenters were twice as likely to be hawks as doves.

There are some striking differences in voting behavior across regions. Most districts have cast the vast majority of their dissents in favor of tighter policy. For example, Boston voters dissented 32 times for tighter policy and only twice for easier policy. On the other hand, voters from Chicago voted 31 times for easing

and did not cast a single dissent for tighter policy. Another remarkable observation is that voters from Philadelphia dissented only once in the 1978 – 2004 period.

Table 6: Dissents by Board Members from 1978 to 2004

	Tightening Dissents		Easing Dissents	
	Number	Share*	Number	Share*
Boston	31	1.00	0	0.00
Kansas City	10	0.91	1	0.09
Dallas	7	0.88	1	0.13
Richmond	2	0.17	10	0.83
Minneapolis	0	0.00	1	1.00
San Francisco	0	0.00	5	1.00
New York	0	0.00	5	1.00
Chicago	0	0.00	31	1.00
<i>No Dissents:</i>				
St. Louis	0	.....	0	.....
Atlanta	0	.....	0	.....
Philadelphia	0	.....	0	.....
<i>No Votes:</i>				
Cleveland	.....	.....	.....	.....
Total	50	0.48	54	0.52

Source: Authors' calculations.

** Dissents in favor of tightening/easing as share of dissents by Board members from that district.*

Tables 6 and 7 take a closer look at these differences across regions, again breaking dissents into those by Board members and those by Bank Presidents. Notably, Board members (shown on table 6) were slightly more likely to dissent for easier policy than for tighter policy. Equally striking, Boston and Chicago account for more than half of the dissents by Board members. Board members from the Boston region have dissented for tighter policy 31 times, with no dissents for easier policy, while those from Chicago have dissented for easier policy 31 times, with no

dissents in the opposite direction.¹⁶ Board members from other districts have also shown pronounced differences in their dissent behavior. For example, voters from Kansas City and Dallas have tended to be hawks like those from Boston, while voters from Richmond, San Francisco, and New York have been relatively dovish. Another systematic difference is that while Board members from Boston and Chicago dissented frequently during our sample, those from St. Louis, Atlanta, and Philadelphia did not cast even a single dissenting vote.

Table 7: Dissents by Bank Presidents from 1978 to 2004

	Tightening Dissents		Easing Dissents	
	Number	Share*	Number	Share*
Richmond	17	1.00	0	0.00
Minneapolis	10	1.00	0	0.00
Atlanta	7	1.00	0	0.00
Cleveland	19	0.90	2	0.10
Kansas City	7	0.88	1	0.13
New York	5	0.83	1	0.17
St. Louis	12	0.80	3	0.20
Dallas	6	0.67	3	0.33
San Francisco	3	0.60	2	0.40
Boston	1	0.33	2	0.67
Philadelphia	0	0.00	1	1.00
<i>No Dissents:</i>				
Chicago	0	.....	0	.....
Total	87	0.85	15	0.17

Source: Authors' calculations.

* *Dissents in favor of tightening/easing as share of dissents by Bank Presidents from that district.*

¹⁶ Through our sample period, the Boston seat has been held by three different people (Henry Wallich, John LaWare, and Roger Ferguson), and the Chicago seat has been held by four individuals (Nancy Teeters, Martha Seger, Susan Phillips, and Susan Bies). The divergence between the voting patterns of the Boston and Chicago Board members appears to have attenuated over time, however, as FOMC dissents have become increasingly rare. The last occupants of these seats – Ferguson and Bies – have never cast a dissenting vote.

The source of these differences in the dissent patterns of Board members remains very much an open issue. As noted above, we think regional concerns may have played a role in driving these results. Whatever the cause, there do seem to have been differences in the frequency of dissent and the direction of dissent across Board members from various regions.

Table 7 highlights the relative hawkishness of the Bank Presidents. Their dissents have been for tighter policy a substantial 85% of the time. There is no regional bank that shows an inclination to dissent consistently for easier policy. One interesting observation is that the Reserve Bank President from Boston has dissented on only three occasions and the President of the Chicago Fed has never dissented, in marked contrast to the frequent dissents by the Board members from these regions.

6. Conclusions

Our examination of Federal Reserve voting data has suggested the following broad conclusions about the features of the FOMC's voting rotation and of voting patterns more generally:

- First, New York appears to have been the most influential district, averaging nearly two votes per FOMC meeting; in addition, Chairmen have often had roots in the New York region. The other districts fall into three tiers of voting strength. Two districts (Chicago and Richmond) have averaged about 1-1/4 votes per meeting. Five districts have averaged about one vote per meeting. And the remaining four districts have averaged roughly half a vote per meeting.
- Second, in a number of instances, we see marked divergences between a region's voting frequency and its relative economic size and population. Most notably, the San Francisco district appears to be significantly underrepresented by these metrics. Such divergences have drawn little attention in the United States, but might be less politically viable in a monetary union composed of nation states such as EMU.
- Third, the extent to which regional identity and regional considerations influence FOMC voting behavior remains an open issue, but we do observe significant differences across regions in the frequency and direction of dissents. The source of these differences merits further examination.
- Fourth, Board members who share a building with and are briefed by the same staff as the Chairman have dissented less frequently on average and have been less hawkish in their dissents than have the regional banks presidents.

References

- Berger, H., Institutional Reform Scenarios, mimeo, October 2005.
- Board of Governors of the Federal Reserve System, The Federal Reserve System Purposes and Functions, Washington DC, June 2005.
- Federal Reserve Bulletin, Washington DC, vol. 28, 1942, pp. 740-741.
- Gildea, J., The Regional Representation of Federal Reserve Bank Presidents, *Journal of Money, Credit and Banking*, vol. 24 (May 1992), pp. 215-225.
- Hearings before the Committee on Banking, Housing, and Urban Affairs of the United States Senate, Nominations of Raoul Lord Carroll and Lawrence B. Lindsey, April 22 and May 7, 1991.
- Meade, E., The FOMC: Preferences, Voting, and Consensus, *Federal Reserve Bank of St. Louis Review* 87:2, 2005, pp. 93-101.
- Meade, E. and N. Sheets, Regional Influences on FOMC Voting Patterns, *Journal of Money, Credit and Banking*, vol. 37 (August 2005), pp. 661-677.
- Meade, E. and N. Sheets, Centralization vs. Decentralization in the Federal Reserve System: Lessons for the ECB, in: E. Meade, ed., *The ECB: How Accountable? How Decentralized?*, Washington, D.C., American Institute for Contemporary German Studies, 1999.

The Future Voting Modalities of the ECB Governing Council

Dominique Servais¹
Banque Nationale de Belgique

Executive Summary

As a consequence of the future enlargement of the euro area, the functioning of the Governing Council will be adapted. The choice for the new voting system was mainly determined by the limitations deriving from the Nice Treaty, by the will to stick as much as possible to the principles on which the EMU was based and by the need to obtain unanimity on the proposal. As a consequence, some models had to be excluded: changes in the composition of the Governing Council, new division of tasks between the Governing Council and the Executive Board whereby the latter would act as a Monetary Policy Committee, creation of constituencies, double majority or weighted voting systems.

As only the voting modalities could be amended, the option of a rotation of the voting rights of the governors was retained. While no change will occur regarding the members of the Executive Board, a maximum number of 15 voting rights will be allocated to the governors of the National Central Banks (NCB's). These voting rights will rotate among them. The speed of the rotation will vary according to the weight of their Member States of origin, the governors of the large Member States benefiting from longer voting intervals than the remaining ones.

Several uncertainties remain regarding this new regime: when will it be implemented, what will the rules be in an euro area composed of 16 to 18 Member States, how will the voting rights rotate?

Two main concerns prevailed when designing the new system: first, the perceived need to take into account the principle of representativeness, in order to preserve the credibility of the decisions taken by the Governing Council and, second, the balance between the Executive Board and the governors in the Governing Council. The introduction of the element of representativeness creates a fundamental difference in the reform of the Governing Council by comparison with

¹ The views expressed in this paper represent the position of the author and are not necessarily attributable to the Banque Nationale de Belgique.

the European Commission, where the rotation system will be based on the strict equality of all members.

In our view, the reform should not only be assessed from the efficiency point of view but also from a broader perspective, i.e. the ability to ensure the smooth functioning of the Monetary Union. This means that various aspects should be looked at: the ability to take decisions, the supranational character of the monetary policy and the acceptability of the decisions by the economic agents, by the political bodies and by the citizens. The paper concludes with an assessment of how the new system performs on these aspects by comparison with a more centralised system.

1. Introduction

1. On 1 May 2004, a historical event took place, namely that of the accession of ten new Member States to the European Union (EU). Without any fuss, a reform of the European Central Bank (ECB) Governing Council entered into force on that same day.² The objective was precisely to adapt its functioning to the future enlargement of the euro area. As no opting out clause had been foreseen for the new Members, they will join the euro in the coming years. The timing is not yet known since this prospect will depend on individual compliance with economic and legal criteria. The reform will therefore only be implemented at a later date, when the euro area will comprise several new Members.

Before describing the new system, we will first briefly recall the origin of the clause introduced in the Nice Treaty enabling the EU Council to adapt the functioning of the ECB Governing Council. It should be remembered that the Council did not get “carte blanche” and several limits were put to its action. We will then explain the new system in the light of the main guiding principles and compare it with the regime that will be put in place for the European Commission. Finally we will assess its possible future impact.

2. Origin and Procedure

2. The main objective of the Nice Treaty was to prepare the EU for an enlargement of an unprecedented size. During the Intergovernmental Conference (IGC), new arrangements were discussed covering all EU institutions, including the European Investment Bank. At a late stage, the French Presidency launched the idea of also reforming the ECB. The idea was accepted. It is safe to assume that in addition to the desire not to create an exception for the ECB, the intention was to

² As a consequence, the (non) ratification of the Constitutional Treaty will not affect the new ECB voting system.

ensure an effective decision-making process in the area of monetary policy after euro area enlargement.

No real discussion took place neither on the possible content of such a reform nor even on some guiding principles for it. This can be explained by several factors: the late introduction of this topic within the IGC, the perception that the euro area enlargement was a much more distant perspective than the EU enlargement; the reluctance of some Member States to embark on a substantial discussion on EMU (Economic and Monetary Union) issues.

As a result, an enabling clause was introduced in the Nice Treaty³, granting to the EU Council the possibility to adjust the voting modalities within the Governing Council of the ECB⁴.

3. Since no guiding principle was agreed for such a reform, several safeguards were introduced regarding the procedure:

- The decision had to be taken by the Heads of State or Government and by unanimity.
- The recommendation for a decision could be made either by the ECB itself or by the European Commission. If it originated from the ECB, an unanimous decision by the Governing Council was required.
- The European Parliament and either the Commission or the ECB (depending on who would present the recommendation) had also to be consulted.
- Finally, the reform had to be ratified by all Member States.

To a certain extent, this procedure can be compared with a “single issue Intergovernmental Conference”⁵.

In a declaration attached to the Final Act of the IGC, the governments of the Member States expressed their expectation that “a recommendation... will be presented as soon as possible” (meaning: after the Nice Treaty enters into force).

The Commission decided not to use its right to make a recommendation unless the ECB proved not to be able to come with a proposal to reform itself.

4. As a consequence, the reform of the ECB Governing Council was decided by the EU Council (meeting at the level of Heads of State or Government) on 21 March 2003⁶, acting unanimously, on the basis of an ECB recommendation⁷. Thereafter the reform was ratified by all the (at that time 15) Member States.

³ Art 10.6 of the Statute on the European System of Central Banks (ESCB) and of the European Central Bank, hereafter called ESCB Statute.

⁴ Only Article 10.2 of the ESCB Statute could be amended.

⁵ R.E. BALDWIN, E. Recommendation EC B/2003/1, under Article 10.6 of the ESCB Statute, for a Council Decision on an amendment to Article 10.2 of the ESCB Statute (OJ 7.2.2003, C 29, p. 6) BERGLÖF, F. GIAVAZZI, M. WIDGREN, Nice Treaty: Should the Treaty of Nice be Ratified?, Monitoring European Integration 11, CEPR, 2001.

⁶ Decision 2003/223/EC, OJ L 83, 1.4.2003, p. 6.

3. No Carte Blanche

5. The Council did not receive a “carte blanche” to amend the decision-making process in the ECB. As we have seen, several constraints were built in the procedure.

On the substance, the constraints were even stricter: only the voting modalities within the Governing Council could be changed.⁸

This means that:

- *The composition of the Governing Council could not be modified.* All the governors of euro area central banks and all Executive Board members will continue to have the right to be present during the Governing Council meetings and to participate in the discussions.
- *The division of tasks between the Governing Council and the Executive Board could not be changed.* The Governing Council will remain the supreme decision-making body, in particular in charge of the monetary policy, the Executive Board being mainly responsible for the preparation of the decisions and for the current business of *the ECB*.
- *The voting rules regarding to decisions with a patrimonial effect could not be amended either.* These decisions will continue to be taken according to the national central banks’ shares in the subscribed capital of the ECB.

6. These constraints imply that a substantial reform of the Governing Council was excluded by the Nice Treaty. A reform limiting the number of members of the Governing Council or implying a different distribution of tasks between the two ECB decision-making bodies was out of the scope of the enabling clause. The creation of a “Monetary Policy Committee”, as suggested by the European Parliament for the longer term⁹, was not possible either. This has to be taken into account when assessing the reform that was proposed by the ECB.

⁷ Recommendation ECB/2003/1, under Article 10.6 of the ESCB Statute, for a Council Decision on an amendment to Article 10.2 of the ESCB Statute, submitted on 3 February 2003 (OJ 7.2.2003, C 29, p. 6).

⁸ D. Servais, P. Vigneron et R. Ruggeri, *Le traité de Nice et son impact sur l’union économique et monétaire*, *European Banking and Financial Law Journal* (Euredia), 2000/4, pp. 489–493.

⁹ For this reason, the European Parliament called for a proposal to be made by the European Convention to be inserted in the draft Constitution. The alternative proposal of the European Parliament consisted in distinguishing “between operational decisions, to be taken by an enlarged Executive Board of nine Members, adequately representing the euro area economy, and strategic and general monetary policy decisions, to be taken by the Governing Council acting on a double majority, based on the population of the Member States, the total size of the economy and the relative size within it of the financial services sector” (OJ 10.3.2004, C 61 E/374).

7. These constraints set by the Nice Treaty on how the ECB should be reformed in order to cope with the future enlargement of the euro area might seem surprising to an external observer.

In fact, the search for efficiency was counterbalanced by the desire of the Member States not to change the basic rules and balances of Monetary Union and, in particular, to guarantee that all NCB governors would retain a seat in the Governing Council. Our participation in the Maastricht Treaty negotiations, clearly showed that while Member States fully accepted the principle of independence, they were at the same time determined that one of their nationals (namely their central bank governor) should participate in the decision-making body charged with monetary policy decisions. This was the price they asked for the willingness to accept abandoning their monetary sovereignty. When the Nice Treaty was signed, the Monetary Union had only lasted for two years and it was certainly too early to change these basic balances.

4. The New Regime

8. Because of the limits defined by the Nice Treaty, the range of possibilities for reforming the functioning of the Governing Council was restricted to changing its voting rules. In order to better understand and later assess the new voting modalities that were introduced, we will first recall the main guiding principles deriving from the Maastricht Treaty (3.1) and explain the main concerns of the ECB when designing its proposal (3.2). We will then present the main elements of the reform (3.3), before detailing the rules that will govern the allocation of the voting rights (3.4). As we will see, the concrete modalities of rotations will be decided later (3.5).

4.1 The Main Guiding Principles Deriving from the Maastricht Treaty

4.1.1 The Two Guiding Principles

9. Further to the limitations enshrined in the enabling clause (see §5 here above), the design of the new voting modalities had to take several principles into account, which can be considered as pertaining to the fundamentals of the Monetary Union:

- the independence principle

10. A first cornerstone of the Monetary Union as it was designed in the Maastricht Treaty is the independence principle. When participating in the Governing Council and when voting, a member shall not seek or take instructions from anybody (Article 107 of the Treaty and 7 of the ESCB Statute). Coupled with the “one

person-one vote”, the independence principle fully ensures the “ad personam” participation of the members of the Governing Council.

- the “one member-one vote” principle

11. The normal voting rule in the Governing Council is “one member-one vote”¹⁰. This principle¹¹, emphasises the fact that all the members of the Governing Council, including the NCB governors, are appointed in their personal capacity and do not represent their countries or their NCBs. They act in an individual capacity¹², “in the interest of, and with due regard to the situation in the euro area as a whole”¹³.

This is the way the Governing Council works today, especially regarding monetary policy decisions.

Even if the enabling clause had allowed changing this principle, the ECB nevertheless regarded it as “the core constitutional principle of the monetary policy of the ECB” and stressed this in its Opinion addressed to the Presidency on 5 December 2000¹⁴.

4.1.2 Impact on Possible Models of Reform

12. On the basis of these two principles, the ECB considered that several possible models for the reform of the Governing Council had to be excluded:

¹⁰ The only case where this principle does not apply are the decisions on certain financial matters where NCBs’ governors act as shareholders in the ECB (Art. 13 of the ESCB Statute).

¹¹ This principle, as well as the participation of all governors in the Governing Council together with the Executive Board members, was seen by the fathers of the ESCB Statute (the Committee of Governors) as strengthening the federative structure of the Eurosystem and the System’s decision-making process. As it was underlined by the Committee of Governors, the “one member-one vote” principle is “conditioned by the need to direct such decisions to the requirements of the Community as a whole rather than to regional considerations”. (See: Committee of Governors of the Central Banks of the Member States of the European Economic Community, Introduction to the Draft Statute of the European System of Central Banks and of the European Central Bank, published by Agence Europe n°1669/1670, p. 14. See also R. SMITS, The European Central Bank, Institutional Aspects, Kluwer Law International, 1997, p. 101.)

¹² See J-V LOUIS, L’Union économique et monétaire, in Commentaire Megret, Le droit de la CEE, 2nd edition, Etudes Européennes, Editions de l’Université de Bruxelles, Brussels, 1995, p. 66.

¹³ H. K. SCHELLER, The European Central Bank, History, Role and Functions, ECB, 2004, p. 54.

¹⁴ See the Opinion of the ECB of 5 December 2000, at the request of the Presidency of the Council of the European Union on a proposal to amend Article 10.2 of the Statute of the European System of Central Banks and of the European Central Bank, OJ 16.12.2000, C 362, p. 14, point 5.

- the introduction of a constituency system. In such a system all governors would play at least an indirect part (through mandating the voting member of their constituency) in the decision-making. However, the governor acting as “constituency representative” would have been mandated by his constituency members and would be accountable to them;
- a reform proposal based on weighted voting;
- a double majority system where the current simple majority voting would be supplemented by a control mechanism to assess whether the assembled majority of governors represents a certain threshold of total euro area population, GDP or any other criteria¹⁵.

These last two proposals were regarded as infringing the “one member-one vote principle” as they would introduce a direct link between the weight of a vote and the country of origin of a governor, jeopardising the supranational character of the monetary policy.

4.2 The Main Concerns

13. In fact, two main concerns prevailed when designing the new system: on the one hand, the perceived need to take into account the *principle of representativeness*, in order to preserve the credibility of the decisions taken by the Governing Council; on the other hand, the *balance between the Executive Board and the governors* in the Governing Council.

4.2.1 The Representativeness

14. A “problematic characteristic” of the euro area enlargement process is its “highly asymmetric” character “because the majority of the acceding countries are small in size and economic power compared to the current EMU average”.¹⁶

The question was therefore raised whether it would be acceptable for the political bodies, the markets and the public opinion, that a majority of Governing Council members might come from countries representing only a small share of the economic activity of the total euro area.¹⁷

¹⁵ The European Parliament rapporteur on this issue proposed such a double majority system as a first step in the reform of the ECB Governing Council, that would be applicable until the euro area has reached the critical mass of 25 Member States (see I. FRIEDRICH, Reform of the Decision-making Rules of the ECB Council in View of EMU Enlargement, *The Way Ahead*, Intereconomics, May/June 2003, pp. 116–119).

¹⁶ M. FRAENKEL and R. FENDEL, The New ECB Voting System: Some Room for Improvement, *Intereconomics*, November/December 2003, p. 334.

¹⁷ In its resolution on the ECB recommendation, the European Parliament also emphasises that “reforms steps must ensure both participation of all ECB Governing Council

15. This was considered as a main concern by the ECB. It therefore considered that “since the introduction of a rotation system could theoretically lead to situations in which the members of the Governing Council having voting rights were from Member States which, taken together, might be perceived as not being sufficiently representative of the euro area as a whole, it should be designed in a manner which excludes such outcomes”¹⁸.

As we will see, the price to pay to meet this concern will be the introduction, to a certain extent, of a national dimension in the participation of the governors in the Governing Council.

4.2.2 The Balance between the Executive Board and the Governors in the Governing Council.

16. With the enlargement of the euro area, additional governors will become members of the Governing Council. As the number of Executive Board members will remain stable, their relative weight, in numerical terms, would decrease in the absence of any reform. To solve this problem, a cap had to be introduced in the number of voting rights allocated to the governors.

17. Finding the appropriate balance between the number of voting members from the Executive Board on the one hand and from the governors’ side on the other hand was a difficult and sensitive point in the discussions.

On the one hand, the Executive Board wished to come to a ratio close to the model of the Deutsche Bundesbank¹⁹ (eight members of the Direktorium, nine Presidents of Land Central Banks) or to the Federal Open Market Committee (FOMC) in the U.S.A. (seven Board members, five Presidents of Federal Reserve District Banks). On the other hand, the governors feared that by reducing the number of voting governors, the Board would be in a position to systematically impose its views, jeopardising the fundamental nature of a “system” of central banks.²⁰

members in decision-making and adequate representation of the euro area economy” (OJ 10.3.2004, C 61 E/374).

¹⁸ Recommendation ECB/2003/1, explanatory memorandum, op. cit., p. 7.

¹⁹ Before the amendment of the Bundesbank Act of 23 March 2002.

²⁰ The Treaty assigns the objective of maintaining price stability and the tasks of conducting the monetary policy (among other tasks) to the European System of Central Banks (composed of the national central banks and the ECB) and not to the ECB itself. The System is governed by the decision-making bodies of the ECB. The national central banks are involved in the system as shareholders of the ECB, through the participation of their governors in the highest governing body (the Governing Council) and through the “reliance on national central banks as operational arms of the System”. The main reason for creating such a system” of central banks was “to fully respect the federative structure

4.3 The Main Elements of the New Regime

18. Taking into account the above mentioned elements, (in particular the fact that all governors continue to participate in the meetings and that the competences of the Governing Council remain unchanged), the ECB considered that a rotation regime of the voting rights within the Governing Council would best fulfil the Nice mandate, and this was accepted by the EU Council.

It was also deemed important that the new voting system should be able to cope with the uncertainty regarding the timing and the sequencing of the euro area enlargement. Some automaticity had to be introduced in the new system in order to avoid the need to change the rules every time a new Member State (or a group of new Member States) enters the euro area. The new rules had therefore to be stipulated in such a way as to allow the system to automatically adjust to the participation of up to 27 governors in the Governing Council.²¹

4.3.1 Three Key Elements

19. The new voting system is based on *three key elements*:

- a) *All governors will be subject to the rotation system.* All governors will thus lose their voting rights from time to time. Conversely, the six Executive Board members will permanently retain their voting rights. They are thus not covered by the rotation scheme. The argument was made that they have a special status, being “the only members of the Governing Council who are appointed at the European level by a Treaty procedure and who operate in the euro area context and for the ECB, the competence of which spans the whole euro area”.²²
- b) *The total number of voting rights within the Governing Council is set at 21, which means 15 voting governors.* These numbers correspond to the legal situation in place until May 2005: since no amendment was made to the Maastricht Treaty at the time of the 1995 enlargement, the Governing Council could theoretically be composed of 15 governors and 6 members of the Executive Board. This implies that the current balance between the Executive Board members and the governors will broadly remain unchanged²³.

of the Community” and the “subsidiarity principle”. (See: Committee of Governors, Introduction to the draft statute, op. cit. p. 14).

²¹ i.e. the current Member States (at that time) and the 12 accession countries listed in the Declaration on the enlargement of the European Union which is annexed to the Treaty of Nice.

²² Recommendation ECB/2003/1, explanatory memorandum, op. cit., p. 6.

One can however observe that all Governing Council members are supposed to act with an European perspective (see the first guiding principle, supra §10).

²³ Even if arithmetically, the Executive Board will need the support of 5 governors in a Governing Council with 15 voting governors, instead of 3 now (in a Governing Council

- c) The voting rights of all governors will rotate but at different speeds. In order to achieve representativeness, differentiation is introduced in the rotation system. Governors will exercise their voting rights with different frequencies depending on the size of their respective Member State, with governors from larger member States enjoying more frequent periods with voting rights than those from smaller Member States.

Groups of governors will be formed and the voting frequency will differ from group to group. Within a group, all governors will enjoy the same voting frequency.

The allocation of a governor to a specific group is determined by a country ranking based on a composite indicator:

- the share of a Member State in the aggregate gross domestic product of the euro area (GDP, at market prices);
- the share of a Member State in the total aggregated balance sheet of the monetary financial institutions of the euro area²⁴ (TABS-MFI).

The first criterion was chosen because the impact of central bank decisions is greater in Member States with larger economies than in those with smaller ones. The second because the size of a Member State's financial sector also has a particular relevance for central bank decisions since the counterparties of central bank operations belong to this sector.²⁵

This composite indicator was heavily criticised: many, including the European Commission, would have preferred opting for the population criterion, besides GDP; others consider the attempt to align Governing Council votes with the economic *and* financial importance in the euro area as “an enlightened approach”²⁶ but stressed that the TABS-MFI does not reflect the whole financial sector and is biased in favour of the particular segment of banks within the financial sector²⁷.

with 12 voting governors), this should not lead in practice to the weakening of the position of the Executive Board in the Governing Council, mainly for two reasons: i) the Executive Board members will permanently be entitled to vote; ii) the cohesion of the Board as a group should get stronger, in contrast to the governors who will be more numerous but will lose their voting rights from time to time. This means that governors will lose power on an individual basis (see M. FRENKEL, R. FENDEL, *op. cit.*, p. 336).

²⁴ A 5/6 weight was given to the GDP criterion and a 1/6 weight to the TABS-MFI one. No rationale was given to explain this ratio, but, according to the ECB recommendation, it ensures “that the financial component is sufficiently and meaningfully represented” (see explanatory memorandum, *op. cit.*, p. 7, comment on Article 1).

²⁵ ECB Monthly Bulletin, May 2003, p. 77.

²⁶ E. E. MEADE, A (Critical) Appraisal of the ECB's Voting Reform, *Intereconomics*, May/June 2003, p. 131.

²⁷ According to the TABS-MFI criterion, Luxembourg has a higher share than UK and the same share as Spain and the Netherlands. It is however likely that the TABS-MFI component will be “exposed to substantial momentum in the coming years especially in

4.3.2 Implications

20. In a certain way, these key elements might be regarded as a reinterpretation of some basic principles of the Monetary Union:

- Some members of the Governing Council will enjoy permanent voting rights, while others will take part in the decisions on a rotating basis only.
- The “one member-one vote” will continue to apply to the Executive Board members; as regards to governors, it will only apply insofar as governors enjoy a voting right. This principle should therefore now be read as “one voting member-one vote”.
- A new element is introduced, namely the need to guarantee the representativeness of the decisions. Representativeness was not deemed to be a cause of concern in a EU composed of 12 or 15 Member States given the relative homogeneity of the Union. As the last enlargement changed this, specific measures had to be taken to ensure the representativeness of the decisions. An adequate balance had however to be found between this concern and the need to preserve the “ad personam” participation of the members of the Governing Council. This led to the introduction of a differentiation between the governors, regarding their voting frequency.

The ECB justified it by the fact that “this is exclusively motivated by the need to accommodate the impact of enlargement on the Governing Council’s decision-making’ and exclusively limited “to the prior determination of the frequency with which each governor has the voting right. For all governors having voting rights at any point in time, the “one member-one vote” principle would continue to apply. Consequently, this differentiation should not impact on actual substantive decision-making”.²⁸

4.4 The Rotation System when the Euro Area Comprises 16 up to 21 Member States

21. In principle, the system for the rotation of voting rights will start operating as soon as the euro area comprises at least 16 Member States.

Governors will then be allocated to two groups:

- the first group, composed of the 5 governors from the Member States which occupy the highest positions in the country ranking, should be assigned 4 voting rights;
- the second one, composed of the remaining governors, should share 11 voting rights.

the accession countries (new Member States)”. (M.FRENKEL , R. FENDEL, op. cit., p. 337).

²⁸ Recommendation ECB/2003/1, Explanatory memorandum, op. cit., p. 7.

- this system will continue to apply until the euro area comprises more than 21 Member States.

22. However, even if the system was conceived for an euro area composed of 16 to 21 Member States, an exceptional adjustment will need to be made in the case where the euro area would temporarily be composed of 16, 17 or 18 Member States:

- If only 4 voting rights were to be allocated to the 5 governors forming the first group, their voting frequency would be lower than the voting frequency of those in the second group.
- A solution could therefore be to shift one voting right from the second to the first group, which means that the governors coming from the big Member States would permanently retain their voting rights during that period.
- Another solution could be to postpone the start of the rotation system until the euro area comprises at least 19 Member States. This can be decided by the Governing Council acting by a two-thirds majority of all its members²⁹. Such a solution would be more in line with the principle that all governors are subject to the rotation scheme, all being equal and having the same voting power³⁰.

Table 1: Euro Area Composed of 16–21 Member States – Voting Frequencies of Governors in Each Group

		Number of governors in the Governing Council								
		16		17		18		19	20	21
1st Group	No. of voting rights/	5/5		5/5		5/5		4/5	4/5	4/5
	No. of governors									
	<i>Voting frequency</i>	100%		100%		100%		80%	80%	80%
2nd Group	No. of voting rights/	10/11	11/11	10/12	12/12	10/13	13/13	11/14	11/15	11/16
	No. of governors									
	<i>Voting frequency</i>	91%	100%	83%	100%	77%	100%	79%	73%	69%
Total voting rights		15	16	15	17	15	18	15	15	15

Source: ECB Monthly Bulletin (May 2003) and author’s calculations.

²⁹ With and without voting rights.

³⁰ Except in financial matters.

4.5 The Rotation System when the Euro Area Comprises 22 Member States or More

23. As soon as the euro area comprises 22 Member States or more, the governors will be allocated to three groups, instead of two:

- The first group will be composed of the five governors from the euro area countries which occupy the highest positions in the country ranking. This group shares four voting rights.
- The second group will be composed of half of all governors³¹ selected from the subsequent positions in the country ranking. This group shares eight voting rights;
- The third group will be composed of the remaining governors. It shares three voting rights.
- This means that the voting frequency within the first group will always remain 80%; in the second group, it will vary from 73% (when the euro area is composed of 22 countries) to 57% (when the euro area is composed of 27 countries); in the third group, the voting frequency will vary from 50% to 38% in the same hypothesis.

Table 2: Euro Area Composed of 22 of More Member States – Voting Frequencies of Governors in Each Group

		Number of governors in the Governing Council					
		22	23	24	25	26	27
1st Group	No. of voting rights/	4/5	4/5	4/5	4/5	4/5	4/5
	No. of governors	4/5	4/5	4/5	4/5	4/5	4/5
	<i>Voting frequency</i>	80%	80%	80%	80%	80%	80%
2nd Group	No. of voting rights/	8/11	8/12	8/12	8/13	8/13	8/14
	No. of governors	8/11	8/12	8/12	8/13	8/13	8/14
	<i>Voting frequency</i>	73%	67%	67%	62%	62%	57%
3rd Group	No. of voting rights/	3/6	3/6	3/7	3/7	3/8	3/8
	No. of governors	3/6	3/6	3/7	3/7	3/8	3/8
	<i>Voting frequency</i>	50%	50%	43%	43%	38%	38%
Total voting rights		15	15	15	15	15	15

Source: ECB Monthly Bulletin (May 2003).

³¹ Rounded up when necessary.

4.6 Concrete Modalities of Rotation

24. The operational details of the rotation system of the voting rights are not yet set.

This includes in particular the length of the periods during which the governors of a group will exercise their voting rights. This will for instance depend on:

- The time interval between the rotation of the voting rights (voting rights can rotate e.g. at the beginning of each month, each trimester, each semester, each year).
- The number of voting rights to be rotated in each of the groups each time rotation occurs (e.g. all the voting rights available in each group, only one or a few).

25. A decision on these issues will be politically sensitive from the point of view of each individual governor. All governors will be particularly eager not to prolong the periods during which they will be deprived of their voting rights. Also from the more global perspective of ensuring the continuity of the decision-making process, a decision will not be easy: continuity can be regarded as implying a stable composition of the group exercising the voting right but also as avoiding large reshuffles of the group exercising the voting right at the beginning of each rotation interval³². So there is a clear trade-off for the two above-mentioned parameters.

Given the complexity and the technicality of the matter as well as the uncertainty related to the sequencing of future euro area enlargements, these operational details were left out for a future decision of the Governing Council. They will be decided on by the Governing Council acting by a two-thirds majority of all its members, with and without voting rights.

5. Comparison with Commission

5.1 Main Features of the Future Commission Rotation Model

26. Contrary to what was done for the ECB, the Nice Treaty already set the guiding principles governing the future composition of the Commission in order to take into account the foreseen enlargements of the Union.

The principles are the following ones:³³

- a) When the first Commission takes up its duties after 1 January 2005, it will comprise one national of each of the Member States.³⁴

³² This could be achieved if fewer voting rights were to rotate more frequently.

³³ Protocol on the enlargement of the European Union annexed to the Maastricht Treaty and to the Treaties establishing the European Communities by the Nice Treaty, Article 4.

³⁴ However, the number of Members of the Commission may be altered by the Council.

- b) When the first Commission takes up its duties after the European Union consists of 27 Member States, “the number of Members of the Commission shall be less than the number of Member States. The Members of the Commission shall be chosen according to a rotation system based on the principle of equality...”. The implementing arrangements shall be adopted by the Council, acting unanimously, and shall contain all the criteria and rules necessary for determining the composition of successive colleges automatically on the basis of the following principles:
- Member States shall be treated on a strictly equal footing as regards determination of the sequence of, and the time spent by, their nationals as Members of the Commission; consequently, the difference between the total number of terms of office held by nationals of any given pair of Member States may never be more than one’;
 - Subject to the latter, “each successive college shall be so composed as to reflect satisfactorily the demographic and geographical range of all the Member States of the Union”.

5.2 Comparison between the Commission and the ECB Model

27. If we compare the rotation systems foreseen for the Commission and for the ECB Governing Council, we note that while the functioning of both institutions is based on the same idea that their members are independent and act on a personal basis, the basic features of the two rotation systems differ:

- The number of Members of the Commission will be reduced (the precise number is not yet decided) while within the Governing Council, the governors of all euro area NCBs will continue to participate (the rotation regards only the voting rights).
- The rotation system within the Commission will be based on the principle of strict equality of all Member States, in all respects, while this principle will only apply to the weight of the vote of the governors within the ECB, allowing different voting rights frequency among governors according to their country of origin.

The rotation system within the Commission only tries to take into account the demographic and geographical range of the Union if it does not prejudice this equality principle of all Member States. On the contrary, as regards the ECB, the representativeness principle was considered important enough to deviate from this principle and to allow for different voting frequencies among governors.

28. How can we explain these differences? Besides more political factors, we see two possible reasons:

- The difference of roles between the two institutions, as it was perceived by the ECB, may have played a role. Not only does their field of competence differ (and monetary policy decisions were probably regarded by the ECB as more

sensitive for the markets) but also their respective roles in the decision-making process.

- The Commission is a much older institution than the ECB (see our remarks in § 7), and in addition, during the Nice Intergovernmental Conference, huge and difficult discussions took place before the Member States finally accepted not having one of their national permanently present in the Commission.

6. Assessment

29. Enhancing the efficiency of the decision-making process was presented in the Nice Treaty as the main objective of the reform of the Governing Council. However, in our view, to assess the reform we should take a broader perspective, i.e. the ability to ensure the smooth functioning of the Monetary Union.

This means that various aspects should be looked at: the ability to take decisions, the supranational character of the monetary policy and the acceptability of the decisions by the economic agents, by the political bodies and by the citizens.

6.1 Many Uncertainties Remain

30. It is difficult to make a firm assessment of the reform today since many uncertainties remain:

- The concrete modalities have yet to be set especially regarding the length and the frequency of the periods during which a governor will be deprived of his voting right (see above §§ 24–25).
- We do not know how the decisions will be taken in this new environment.

Today, Governing Council decisions are mainly taken by consensus. However, in practice, “consensus” is applied in a rather dynamic way: it does not mean that decisions are postponed until all members of the Governing Council agree. On the contrary, when the positions of most Governing Council members are known and diverging, the President often makes a proposal taking into account the majority view and the other members are invited to join the majority, knowing that in the end, the decision can be taken by a simple majority anyway. Such a “dynamic consensus” reinforces the collegiate character of the decisions taken by the Governing Council and the team spirit among its members.

Will the Governing Council continue to pursue such a “dynamic consensus”?

Will the enlargement, on the contrary, be used as an argument to introduce more formal voting?

In both cases, it will be interesting to see whether and how the non voting governors will be taken on board in particular when critical decisions are taken with serious implications for them. This is an important question if we want to ensure in the long term the continuity of the decisions, the unity of the system and the acceptability of its decisions.

For most of these aspects, the President will play a key role. He will indeed be the person who will decide on these issues and, in the end, who will allow for a smooth functioning of the Governing Council.

6.2 The New Voting Modalities

31. If properly implemented, the reform can ensure that after the enlargement of the euro area,

- The Governing Council will still be able to take decisions in time.³⁵
- The supranational character of the monetary policy should be preserved. When sitting at the table of the Governing Council, all members will continue to have the same weight.³⁶
- The acceptability by the economic agents will be guaranteed by the fact that the system ensures that decisions are taken by members coming from countries representing a large share of the economic activity of the total euro area;
- The acceptability by political bodies was confirmed by the decision of the EU Council and its ratification by the Member States;
- The acceptability by the citizens will clearly benefit from the participation of all governors to the discussions.

6.3 Comparison with a More Centralised System

32. The reform of the Governing Council was criticised by several observers as being too cautious. They argue that efficiency could be best ensured by limiting the size of the Governing Council or by transferring some of its powers to an enlarged Executive Board or to a Monetary Committee composed in such a way as to maintain an euro area-wide view. As we have seen, both measures could not be retained on the basis of the Nice Treaty.

Would such a system be more efficient?

A more centralised system should be able to take decisions faster, since the number of persons involved would be more limited.

³⁵ If the current practice of looking for a consensus even if dynamic is to be pursued, the limitation of the number of voting rights will help to avoid undue delays in the decision-making process. On the contrary, this limit (which can be justified on other grounds, such as for representativeness reasons) does not add a lot in terms of ensuring fast decisions if more formal voting is introduced (when voting, the ability to decide quickly does not primarily depend on the number of members participating to a vote).

³⁶ The risk mentioned by some authors that the differentiation introduced in the voting frequency of the governors might “cultivate thinking in national categories” (see I. FRIEDRICH, *op. cit.* p. 120) should be weighted by the fact that the experience has shown that when taking monetary policy decisions Governing Council members usually sit on the same side and adopt a euro area perspective.

33. However, even if such a more centralised system is sometimes also presented as the best way to safeguard the supranational character of the Monetary Union, things are more nuanced.

For instance, an IMF working paper³⁷ highlights the advantages of maintaining the current balance between the Board and the governors in the Governing Council. Two arguments are invoked: first, the role that governors play in providing the ECB with first-hand and on-the-spot analyses of national developments, “especially in the case of a currency union that encompasses a large number of heterogeneous countries and regions”; second, the optimisation of monetary policy, since the presence of a governor from each Member State “might be a means to moderate the impact of political preference shocks on monetary policy”.³⁸

To a certain extent, the presence of national governors in the Governing Council could be regarded as a safeguard for the independence of the decision-making body in charge of monetary policy decisions. In their absence, it is likely that Member States will fear that nobody will listen to their domestic problems. So they might be tempted to exert more direct pressure on the ECB.

In the same sense, looking at the U.S. example, a Fed study reveals that when deciding on monetary policy, central bankers at the hub (the Federal Reserve Board members, in Washington) do take regional developments more into account than central bankers in the spokes (the Reserve Bank Presidents).³⁹

34. The acceptability by the economic agents of the decisions taken by a more centralised body should not be a problem.

By contrast, on the political side, as stated by Frenkel and Fendel, Member States do not seem “ready to accept such a loss of power... Realistically, it must be admitted that the EMU is not yet ready for such a high degree of centralisation... A

³⁷ H. BERGER, *The ECB and Euro-Area Enlargement*, IMF Working Paper, October 2002, pp. 28–29.

³⁸ “In a fully centralised scenario, a relatively small number of Board members would be chosen through a selection process on the European level that could favor the politically most influential countries in the eurozone. In a completely decentralised process, however, each government would select a central bank governor for a relatively large ECB Council. The latter might be preferable simply because, if political shocks differ across member countries, a fully decentralised nomination process will allow country-specific preference shocks to offset each other to a greater extent than a less balanced, more centralised appointment process. Thus the current ECB policymaking process, which balances the decision power in the ECB Council between the Board and central bank governors and puts the nomination of the latter entirely in the hands of national governments (...) might help moderate monetary policy in a polarised world with random shocks to government preferences, and thus increase the ECB’s political independence in this sense”.

³⁹ E. E. MEADE, D. N. SHEETS, *Regional influences on U.S. monetary policy: some implications for Europe*, Board of Governors of the Federal Reserve System, International Finance Discussion Papers, Number 721, February 2002.

higher degree of centralisation can only be reached through an evolutionary learning process".⁴⁰

Often neglected, the acceptability by the citizens should also be taken into account. This is perhaps the aspect where a more centralised system appears to be the weakest.

Centralised communication is not very efficient. The experience has shown that because of the different cultures, languages and traditions, governors play a crucial role in this regard.

Currently, the participation of all governors facilitates the communication between the ECB and the citizens of the whole euro area. Their proximity also reassures the citizens that their concerns are taken into account. Tough decisions are more likely to be accepted as necessary and legitimate if all countries are represented in the decision-making body.⁴¹

35. One of the lessons of the referenda in France and in the Netherlands is, in our view, that besides the need for efficiency, we should also stress that need for European institutions to be as close as possible to the citizens. To a certain extent, the ECB reform as it was approved, anticipated this by preserving the role of NCB governors in the main decision-making body of the Eurosystem.

⁴⁰ M. FRENKEL, R. FENDEL, *op. cit.*, p. 336.

⁴¹ D. GROSS, *An opportunity missed*, *Intereconomics*, May/June 2003, p. 128.

Contributors

Christian Barontini joined Banque de France in 1999 in the Foreign Economies Studies Division where he was in charge of the macroeconomic monitoring and of forecasts for the main European continental economies. In early 2003, he was designated to the Eurosystem's Monetary Policy Committee Task Force on Sectoral Specialisation in the EU. Since end 2003, Christian Barontini has been an economist at the European Relations Division, in charge of ECB Governing and General Councils meetings matters. He is more specifically in charge of institutional affairs related to the ESCB/Eurosystem. Christian Barontini graduated from the IEP (Institut d'Etudes Politiques) of Aix-en-Provence in 1994 and participated in an exchange program at McGill University in Montréal in international economics and political science.

Helge Berger (born in 1965) was educated in Munich, Germany, where he received his Ph.D. in 1997 and the *venia legendi* for economics in 2002. Since 2003, he holds the chair of monetary economics at Free University Berlin. He taught at Princeton University as a John Foster Dulles Visiting Lecturer (1997–98), helped to develop the Munich-based CESifo network as its research director (1999–2001), and worked as an economist for the IMF's European department (2001–2003). Since 2004 he is a member of the *Ausschuss für Geldtheorie und Geldpolitik* (*Study Group on Monetary Economics*) of the German Economic Association. He has been a visiting scholar at the European Central Bank, the IMF, and at a number of universities, including in Copenhagen, Bergen, and Stockholm. Much of his research is in the fields of macroeconomics and monetary economics. Recent work has focused on issues of central bank design in federal currency unions, central bank communication, and the trade effects of the euro. His publications include papers on the impact of central bank conservatism on monetary policy (*Economic Journal*), studies on optimal exchange rate regime choice (e.g., in *Emerging Markets Review*, *Economics Letters*), an analysis of the determinants of IMF credit (*Economic and Politics*), and – from occasional ventures into the realm of economic history – papers on the Bundesbank's path to independence (*Public Choice*) and the economic determinants of the European revolutions of 1848 (*Journal of Economic History*).

Philippe Bonzom is the Deputy Director of International and European Relations at the Banque de France, in charge, *inter alia*, of Eurosystem and EU matters and a member of the Eurosystem's Communication Committee. Previously, he had been head of the European Relations Division, Advisor to the IMF Executive Director

for France, and, upon entry at Banque de France, economist with the unit in charge of Paris Club debt rescheduling. From 1995 to 2002, he was secretary of the Banking and Financial Working Group on the changeover to the euro (in France). Philippe Bonzom graduated from HEC (Hautes Etudes Commerciales) in 1981 and is Master of Law (Jean Monnet University of Sceaux) and Economics (Rennes University). Since 1994, Philippe Bonzom has published several articles on regional integration.

Josef Christl was born in 1952 in Mattighofen, Austria. He studied business administration at the University of Graz and economics at the University of Vienna and the Institute for Advanced Studies (IHS). He started his career as an economist at the Ministry of Social Affairs. From 1984 to 1993, Josef Christl held the position of Senior Economist at Creditanstalt to become Chief Economist of Creditanstalt in 1993. In 2001, he was appointed Chief Economic Advisor to the Austrian Minister of Finance. In 2003, Josef Christl joined the Oesterreichische Nationalbank, where he holds the positions of Executive Director Economics and Financial Markets and Member of the Governing Board. In addition, Josef Christl is a Professor at the Vienna University of Economics, Alternate Governor for the Republic of Austria – International Monetary Fund, Member of the Supervisory Board – Austrian Financial Market Authority. He is the author of various publications in the field of monetary theory, labour economics, European integration and business cycle research.

Sandra Dvorsky studied Commercial Sciences at the Vienna University of Economics and Business Administration. In 1991, she joined the Oesterreichische Nationalbank (OeNB), where she spent more than ten years at the Foreign Research Division, doing economic analysis of Central and Eastern European transition countries (CEEC). Furthermore, she was the OeNB's coordinator of technical cooperation with CEEC central banks. Since 2002, Sandra Dvorsky has been working with the European Affairs and International Financial Organizations Division of the OeNB. Sandra Dvorsky has published several articles on central bank independence in CEEC, Southeastern Europe as well as on the measurement of central bank independence in the past years. Furthermore, she has also published articles on the institutional changes in the OeNB after Austria's EU accession, the adjustment of the voting modalities in the ECB Governing Council and on the Progress Reports from a central bank's viewpoint.

Rossen Grozev is the Director-General at the Balgarska Narodna Banka (BNB). He participates in the drafting of the new Bulgarian financial and banking legislation aiming the transposition of the legal framework of the European Union (EU). He was a member of the Bulgarian negotiating team for EU accession in the areas of Free Movement of Capital, Free Movement of Services, as well as Economic and Monetary Union. He took part as a Bulgarian representative in the United Nations Commission on International Trade Law (UNCITRAL) Working

Group VI (Security Interests). Having obtained a Degree in Law from the Sofia University and LL.M. (with Distinction) from the University of Warwick, U.K., Mr. Grozev is a visiting lecturer in EU Law, as well as in Banking and Securities law, at the Sofia University “St. Kliment Ochridsky” and at the University of Economy in Sofia. He has published two books on the EU legal regime of banking and finance and more than thirty papers on legal issues mainly connected with EU law, banking regulation and financial problems.

Isabella Lindner graduated from the Vienna University of Economics and Business Administration in 1987. She holds a Diploma in International Affairs from the School of Advanced International Studies (John Hopkins), University of Bologna. In 1988, Isabella Lindner joined the Oesterreichische Nationalbank (OeNB) as an economist and in 1991, she became Financial Attachée of the Austrian Mission to the European Community in Brussels. In 1995, she returned to Austria and started working as the assistant of Director Thomas Lachs (OeNB). From 1997 to 2000, Isabella Lindner worked for the Austrian Minister of Finance Rudolf Edlinger as his adviser for International and European Affairs. Since 2000, she holds the position of Deputy Head of the European Affairs and International Financial Organisations Division of the OeNB.

Adolf Matejka was born in Daruvar, Croatia on December 6, 1950. He graduated from the Zagreb Faculty of Economics in 1973, and received his Master’s degree in 1984. He started his career as a trainee at the Hrvatska Narodna Banka (HNB) and the Zagrebacka Banka. Following his traineeship, he was an inspector at the HNB, exercising control over commercial banks – especially their credit activities. In the period from 1981 to 1985, he was Head of the Primary Issue Operations Division. From 1985 to 1989, he worked as a Senior Adviser, and Deputy Director of the Credit Operations Department and was responsible for proposing monetary policy measures. In 1989, he was appointed Director of the Credit Operations Department. In 1994, he was appointed Executive Director of the Central Banking Operations Area. A very important year in his professional career was 1996, when he was appointed Chairman of the Working Group for the Introduction of the kuna into the Croatian Danube Region. In 1999, the HNB Council appointed Adolf Matejka as a temporary administrator in the Croatia Banka Zagreb. In 2000, he resumed the position of the Executive Director of the Central Banking Operations Area. He was appointed Vice Governor of the HNB in 2001. Vice Governor Matejka is responsible for the coordination and management of affairs in the field of Foreign Exchange Operations Area and International Relations Area.

Ellen E. Meade is an Associate Professor of Economics at American University and an Associate Fellow of Chatham House. She was a researcher at the Centre for Economic Performance at the London School of Economics and the Federal Reserve Board, and was on the staff of President Clinton’s Council of Economic Advisers. Her research focuses on central banking, monetary policy, and exchange

rates. She holds a BA degree from Duke University, and an MA and Ph.D. from Princeton University.

Tommaso Padoa-Schioppa is engaged as a Counsellor of the Institute of International Affairs (Rome) and is a former Member of the Executive Board of the European Central Bank. His earlier appointments include: Director-General for Economic and Financial Affairs at the Commission of the European Communities (1979–1983), Deputy Director General of the Banca d'Italia (1984–1997) and Chairman of the Commissione Nazionale per le Società e la Borsa (1997–1998). He holds a honorary professorship (Economics) from the University of Frankfurt am Main.

His past functions also include: Joint Secretary to the Delors Committee for the study of European Economic and Monetary Union (1988–1989); Chairman of the Banking Advisory Committee of the Commission of the European Communities (1988–1991); of the Working Group on Payment Systems of the Central Banks of the European Community (European Monetary Institute) (1991–1995); of the Basle Committee on Banking Supervision (1993–1997); of the European Regional Committee of the International Organisation of Securities Commissions (IOSCO), which comprises 34 countries (1997–1998); of the FESCO (Forum of the European Securities Commissions) (1997–1998); of the G10 Committee on Payments and Settlement Systems (2000–2005).

He is a Member of the Group of Thirty (since 1979); Member of the Advisory Board of the Institute for International Economics (IIE); President of the International Center for Monetary and Banking Studies (Geneva).

He graduated from the Luigi Bocconi University, Milan, Italy, in 1966 and received a Master of Science from the Massachusetts Institute of Technology. Tommaso Padoa-Schioppa is the author of numerous books and articles and he is Cavaliere di Gran Croce della Repubblica d'Italia.

Martin Pöder was born in Viljandi, Estonia in 1966. In 1991, he graduated from the Economics Department of the Tallinn Technical University. In the beginning of his career, he was employed at the Ministry of Finance of Estonia as the Head of the Department for International Relations. In 1994, he was appointed Assistant to the Executive Director for the Nordic and Baltic countries of the World Bank. In 1997, Martin Pöder started again to work for the Ministry of Finance as the Deputy Secretary General for international relations, EU integration and foreign financing. This was followed by the appointment as Alternate Director for Sweden, Iceland and Estonia with the European Bank of Reconstruction and Development. Since 2003, he has been working for Eesti Pank as the Head of the International and External Relations Department.

Cristian Popa (born in 1964) is Deputy Governor of the Banca Națională a României (BNR). In this capacity, he coordinates monetary and exchange rate policy, research, publications, econometric and forecasting, European integration,

and international relations. His responsibilities include advising government on behalf of the BNR on external sovereign debt issuance and the ratings agency dialogue. He was appointed by Parliament for a second mandate (5 years) starting October 11, 2004. He is also Vice President of the BNR's Monetary Policy and Supervision Committees and a Member of its Board of Administration, as well as of the Asset Management Committee of the BNR. He serves as the head of the BNR's task force responsible for preparing the introduction of inflation targeting. Cristian Popa additionally serves on the editorial boards of the *Romanian Journal of European Affairs* and *Oeconomica* and is an honorary Member of the Board of Directors of the Romanian Academy's Institute for Economic Forecasting. He is World Bank alternate governor for Romania.

Cristian Popa joined the BNR in 1998 as a Senior Advisor to the Governor and the Chief Economist. Previously, he was active in research (between 1991 and 1998, he was a Senior Research Fellow with the Institute of National Economy in Bucharest) and government reform; and as well Director of Macroeconomic Policy Coordination within the Department of Economic Reform of the Romanian government). He completed a first mandate as the BNR's Deputy Governor between 1998 and 2004. He was Fulbright fellow with Harvard University (1994–1995), ACE-PHARE visiting fellow with the NIESR (London, 1997) and visiting scholar with the University of Michigan (Ann Arbor, 1997). He has lectured or given presentations at, among others, Harvard University, the London School of Economics, the London Business School, the Royal Institute of International Affairs (Chatham House), St. Mary's College of Maryland, the Oesterreichische Nationalbank, the Economic Planning Agency of Japan and the Global Forum (Tokyo).

In addition, Cristian Popa is the author of numerous papers focusing on monetary policy, international trade and trade policy, inflation, exchange rates, financial indiscipline, privatization, banking system reform, and other issues pertaining to transition and developed economies.

Paul Schmidt studied International Relations at the University of Vienna and the Diplomatic Academy of Vienna. In 2001, he joined the European Affairs and International Financial Organizations Division of the Oesterreichische Nationalbank (OeNB), where he prepares international meetings and analyses European economic and institutional issues. He was sent on short-term secondments to the Organisation for Economic Cooperation and Development, the Bank for International Settlement and the European Union. Paul Schmidt has published articles on EU enlargement and the Constitutional Treaty for Europe.

Alexandra Schober-Rhomberg studied at the University of Economics in Vienna and graduated in 1987. She also received postgraduate education at the International University Institute in Luxembourg. After starting her professional career as a financial consultant at Merrill Lynch, she worked for the Directorate for

Banking, Insurance and Securities Markets of the EFTA Surveillance Authority in Brussels. In 1995, Alexandra Schober-Rhomberg joined the European Affairs and International Financial Organisations Division of the Oesterreichische Nationalbank.

Dominique Servais is the Head of the ECB Coordination Unit at the Banque Nationale de Belgique (BNB). In this capacity, he advises the Governor of the BNB on the issues dealt with by the Governing Council of the ECB. He is currently a member of the Legal Committee (LEGCO) of the ESCB. As a Graduate in Law and International Relations of the Université Catholique de Louvain, in 1983, he joined the International Department of the BNB. From 1990 to 1995, he was appointed Financial Counselor at the Permanent Representation of Belgium to the European Union. He then participated in the negotiations of the Maastricht Treaty and chaired several groups of the Council in charge of Economic and Monetary Union (EMU) secondary legislation and financial services directives. Thereafter, in 1999, he was appointed Head of the International Department of the BNB before being assigned to his current position. He is the author of several publications in the field of financial services and economic and monetary union.

D. Nathan Sheets studied Economics and graduated from Brigham Young University in 1989. In 1993, he received his Ph.D. in Economics from the Massachusetts Institute of Technology. Since 1993, he has worked in various positions as a staff economist at the Board of Governors of the Federal Reserve System and is currently Assistant Director in the Division of International Finance. Among other publications, he is the author of *Regional Influences on FOMC Voting Patterns* (with Ellen E. Meade). He is particularly interested in international finance, open economy macroeconomics, and development economics.

Toni Stojanovski, born in 1972, studied at the Faculty of Economics of the University St. Kiril and Metodij in Skopje. After graduating in 1996, he completed his university career with post graduate studies on finance and monetary policy. In 1996, he joined the Supervision Department of the Narodna Banka na Republika Makedonija. In 2004, he was appointed Deputy Director of the Supervision Department and Coordinator for the preparation of the New Law on the Narodna Banka na Republika Makedonija. Since 2004, he has also been involved in the work of the Working Group for the Banking Regulation of the Ministry of Finance.

Carel C. A. van den Berg, presently Adviser to the Financial Stability Division and Coordinator of the Centre for Technical Cooperation with Transition Economies of De Nederlandsche Bank (DNB), has been closely involved over the period from 1989 to 2004 in the process leading up to the Treaty of Maastricht and the establishment and the first years of the European System of Central Banks. First as a Senior Economist, preparing the meetings of the Committee of Governors for Duisenberg, then president of the DNB, and later as Deputy and Alternate

Departmental Director in the International Affairs Department and the Monetary and Economic Policy Department. His professional experience also includes two years at the International Monetary Fund from 1987 to 1989. He holds a doctor's degree in economics. His dissertation (2004) is titled *The Making of the Statute of the European System of Central Banks – An Application of Checks and Balances*.

D. Derya Yeşiladali graduated from the Faculty of Law of the University of Ankara and the Academy of American and International Law of the University of Texas in Dallas. After working as a private lawyer in Ankara, she became a lawyer for the Türkiye Cumhuriyet Merkez Bankası (TCMB) in 1984. Since 1994, she has been working as a Senior Legal Adviser for the TCMB. Her main fields of interest are central bank issues and international banking, European Community Legislation and European Central Bank Regulations. D. Derya Yeşiladali represented the TCMB in many forums and took part in IMF Worldbank evaluation visits.

List of “Workshops – Proceedings of OeNB Workshops”

For further details on the following publications see www.oenb.at

	<i>published</i>
No. 1 The Transformation of the European Financial System “Where Do We Go – Where Should We Go?” <i>Vienna, 20 June 2003</i>	7/2004
No. 2 Current Issues of Economic Growth <i>Vienna, 5 March 2004</i>	7/2004
No. 3 60 Years of Bretton Woods – The Governance of the International Financial System – Looking Ahead <i>Vienna, 20 to 22 June 2004</i>	12/2004
No. 4 A Constitutional Treaty for an Enlarged Europe: Institutional and Economic Implications for Economic and Monetary Union <i>Vienna, 5 November 2004</i>	2/2005
No. 5 Macroeconomic Models and Forecasts for Austria <i>Vienna, 11 to 12 November 2004</i>	5/2005
No. 6 Capital Taxation after EU Enlargement <i>Vienna, 21 January 2005</i>	10/2005
No. 7 The European Integration Process: A Changing Environment for National Central Banks <i>Vienna, 21 October 2005</i>	3/2006

Periodical Publications of the Oesterreichische Nationalbank

For further details see www.oenb.at

Statistiken – Daten & Analysen

quarterly

This publication contains reports and analyses focusing on Austrian financial institutions, cross-border transactions and positions as well as financial flows. The contributions are in German, with executive summaries of the analyses in English. The statistical part covers tables and explanatory notes on a wide range of macroeconomic, financial and monetary indicators. The tables including additional information and data are also available on the OeNB's website in both German and English. This series also includes special issues on selected statistics topics that will be published at irregular intervals.

Monetary Policy & the Economy

quarterly

This quarterly publication, issued both in German and English, offers analyses of cyclical developments, medium-term macroeconomic forecasts and studies on central banking and economic policy topics. This publication also summarizes the findings of macroeconomic workshops and conferences organized by the OeNB.

Financial Stability Report

semiannual

The *Financial Stability Report*, issued both in German and English, contains first, a regular analysis of Austrian and international developments with an impact on financial stability and second, studies designed to provide in-depth insights into specific topics related to financial market stability.

Focus on European Economic Integration

semiannual

Focus on European Economic Integration, the successor publication to Focus on Transition (published up to issue 2/2003), contains a wide range of material on Central and Eastern European countries (CEECs), beginning with a topical economic analysis of selected CEECs. The main part of the publication comprises studies, on occasion several studies focusing on a special topic. The final section provides information about the OeNB's CEEC-related activities and conferences as well as a statistical annex.

Annual Report*annual*

The *Annual Report* of the OeNB provides a broad review of Austrian monetary policy, economic conditions, new developments on financial markets in general and financial market supervision in particular, as well as of the OeNB's changing responsibilities and its role as an international partner in cooperation and dialogue. It also contains the financial statements of the OeNB.

Economics Conference (Conference Proceedings)*annual*

The *Economics Conference* hosted by the OeNB represents an important international platform for exchanging views on monetary and economic policy as well as financial market issues. It convenes central bank representatives, economic policy decision makers, financial market players, academics and researchers. The conference proceedings comprise all papers, most of them in English.

Workshops – Proceedings of OeNB Workshops*recurrent*

The proceedings of *OeNB Workshops* were introduced in 2004 and typically comprise papers presented at OeNB workshops at which national and international experts, including economists, researchers, politicians and journalists, discuss monetary and economic policy issues. Workshop proceedings are available in English only.

Working Papers*recurrent*

The *OeNB's Working Paper* series is designed to disseminate, and provide a platform for discussing, findings of OeNB economists or outside contributors on topics which are of special interest to the OeNB. To ensure the high quality of their content, the contributions are subjected to an international refereeing process. The opinions are strictly those of the authors and in no way commit the OeNB.

**Conference on European Economic Integration
(Conference Proceedings)***annual*

(formerly East-West Conference)

This series, published by a renowned international publishing house, reflects presentations made at the OeNB's annual central banking conference on Central, Eastern and Southeastern European issues and the ongoing EU enlargement process.

For further details see *ceec.oenb.at*

Newsletter of the Economic Analysis and Research Section *quarterly*

The English-language *Newsletter of the Economic Analysis and Research Section* is only published on the Internet and informs an international readership about selected findings, research topics and activities of the Economic Analysis and Research Section of the OeNB. This publication addresses colleagues from other central banks or international institutions, economic policy researchers, decision makers and anyone with an interest in macroeconomics. Furthermore, this newsletter offers information on publications, studies or working papers as well as events (conferences, lectures and workshops).

For further details see *hvw-newsletter.oenb.at*