

Understanding Central Banks' Role in Enlargement – Governance Issues

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The EU's enlargement policy is enshrined in the Treaty on European Union, which lays down the requirements for the accession of any European state. It is against this background that Southeastern European (SEE) national central banks (NCBs) strive to prepare for the challenges of enlargement.

This paper relies on the practical experience with three EU accession support projects of the European System of Central Banks (ESCB) to draw a general EU accession road map for applicant countries on which the accession framework for an NCB should be based. During preaccession, an NCB would be well advised to develop governance to improve its decision-making capacity. In this paper, we have defined three forms of governance: First, good governance to ensure the fulfillment of economic, legal and institutional requirements; second, external governance for an NCB to participate in accession coordination at the national and EU level; and third, internal governance comprising operational and institutional changes inside an NCB.

If NCBs do not pursue a consistent path toward good governance, they might – in the medium to long run – be affected by risks of a strategic, economic, operational and institutional nature. Thus, successful acceding NCBs make EU accession a top priority of their strategy. An NCB's policy of coordination should be the key policy for effective central bank governance. We therefore recommend that an NCB establish an EU coordination mechanism, an EU coordinator, coordination guidelines and an EU Scenario Process to continuously implement the changes necessary for successful ESCB/EU membership. This process will be more effective if NCBs cooperate in technical projects and draw on the experience of other NCBs.

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1 Introduction

The EU's enlargement policy is enshrined in the Treaty on European Union², which lays down the requirements for the accession of any European state. In December 2006, the European Council renewed the consensus on enlargement among the EU-27 on the basis of the consolidation of commitments, fair and rigorous conditionality and good communication with the public. The EU's capacity to integrate new members is also a key concern. The explicit aim is to extend the zone of peace, stability, democracy and prosperity (European Commission, 2011b). The countries of the Western Balkans have made essential steps toward enlargement: Croatia is scheduled to join the EU in July 2013; the Former Yugoslav Republic of Macedonia, Montenegro, and Serbia have candidate status; Albania as well as Bosnia and Herzegovina are still potential candidate countries.³ It is against this background that the national central banks (NCBs) of Southeastern Europe (SEE) strive to prepare in the best possible way for the challenges of enlargement. In our experience, NCBs can significantly contribute to successful European integration because they are highly professional economic policy actors and usually

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² Article 49 of the Treaty on European Union; formerly Article 237 of the EEC Treaty.

³ With regard to Kosovo, the European Commission has adopted a Communication on a Feasibility Study for a Stabilisation and Association Agreement (SAA). This study confirms that an SAA can be concluded between the EU and Kosovo in a situation where EU Member States maintain different views on status (European Commission, 2012a).

enjoy credibility in their respective countries. This credibility is an asset when communicating reform requirements in the run-up to accession, but also during EU membership.

The European integration process at its various stages poses different challenges for all these NCBs. These challenges are first, participation in the EU accession screening and negotiations; second, fulfillment of the economic and legal requirements for EU membership; and third, the institutional preparation and organizational changes for EU membership, including integration into the European System of Central Banks (ESCB). However, some uncertainty reigns as to the conditions to be fulfilled on the way to EU membership, which obviously comprise more than just complying with the *acquis communautaire*, the body of EU law. The step-by-step integration of the NCBs into the European economic and financial decision-making mechanisms and the respective EU/ESCB committees changes their role as well as their working methods at all hierarchical levels and in all areas of their work. How are the main institutional, economic and legal governance issues for successful integration determined? What sort of governance models and blueprints should NCBs follow on their way to integration?

Based on the assumption that central banks are both “complex institutions which straddle the ground between politics and economics” and “public policy institutions involved in economic governance at the national, international and EU levels” (Quaglia, 2008), our study has a twofold aim: first, to describe the role of a central bank in accession, its policy instruments for effective integration, and second, to investigate the practical relevance of a central bank’s governance as a key policy instrument. How we consider and design the governance mandate of a central bank in accession as well as what focus we put on devising the policy of coordination inside the central bank in the strategic context of accession is our main contribution to the current debate between academics and practitioners in the enlargement area. We demonstrate that the new tasks and activities specific to a central bank in accession and their appropriate institutional setting is a matter of degree. Moreover, only an efficient policy of coordination inside the central bank leads to effective central banking governance.

The paper starts by sketching out the challenges of the European integration process at its various stages. Section 2 presents a general EU accession road map for applicant countries on which the accession framework for an acceding central bank should be based. Section 3 elaborates on a number of features of central banking governance that a central bank could develop during enlargement to improve its policy of coordination and hence its decision-making capacity. In this context, we define three forms of governance: First, good governance to ensure the fulfillment of economic, legal and institutional EU requirements; second, external governance determining an NCB’s participation in accession coordination at the national and at the EU level; and third, internal governance comprising operational and institutional changes required inside an NCB. In all three types of governance, the policy of coordination plays a decisive role in achieving good governance at all stages of enlargement and after accession. Section 4 concludes.

Our analysis and descriptions are based mostly on practical experience, which we gathered in three ESCB projects funded by the Instrument for Pre-Accession Assistance (IPA) and coordinated by the European Central Bank (ECB), namely the Technical Assistance Programme for the National Bank of Serbia (ESCB Needs Analysis for

the National Bank of Serbia; 2008 to 2009⁴), the Eurosystem Technical Assistance Programme for the Central Bank of Bosnia and Herzegovina (2010 to 2011), and the Central Bank Cooperation Programme with the National Bank of Serbia (Strengthening the institutional capacities of the National Bank of Serbia; 2011 to 2013). These projects covered several areas of central banking, including EU accession support, which centered on introducing best practice and reaching EU standards in EU coordination.

2 Accession Framework – The Road Map

The 2003 European Council in Thessaloniki confirmed that the future of the Western Balkans lies within the EU once conditions for membership have been met. To quote Winston Churchill (Macmillan, 2008), “the Balkans produce more history than they can consume”; therefore, special care will have to be applied to the political, economic and cultural (re)integration of the Western Balkans. However, to ensure the continued support of the present EU Member States and given the experience of past enlargements, there will be no “discounted membership.”

While the EU “deepening versus widening” dilemma was very fashionable at the beginning of the 21st century as one of the core questions in the field of European integration (De Witte, 2002; Kelemen et al., 2011), not too much literature was written on policy responsibility and the effectiveness of task allocation. As Miles (2004) put it, “economists are far from having developed anything like a comprehensive theory to enable us to understand the all-embracing nature and impact of EU enlargement.” The recent global financial crisis and the present difficulties in some euro area countries have highlighted the importance of a further consolidation of economic and fiscal governance in the euro area. EU policy options in enlargement will therefore also be influenced by the way the EU will evolve as a political and economic multi-dimensional entity.

2.1 EU Accession – How Is It Done at the EU Level?

In six rounds of enlargement,⁵ the EU has gradually refined the procedures and conditions to guide and assist a candidate country in preparing for its obligations as a Member State. All applicants are expected to join the EU on the basis of the same criteria,⁶ though at their own pace, depending on their individual progress in putting into place and implementing the necessary reforms and conditions. Strengthening the rule of law, improving governance, providing for capacity and institution building and implementing economic reforms according to the Europe 2020⁷ concept are major change challenges for countries in the Western Balkans. The accession process is a powerful tool for transforming national institutions, as the EU applies economic and political conditionality and monitors progress at every stage of accession. This conditionality provides the incentive to

⁴ Funded by Community Assistance for Reconstruction, Development and Stabilisation (CARDS).

⁵ 1973: Denmark, Ireland, the United Kingdom; 1981: Greece; 1986: Portugal, Spain; 1995: Austria, Finland, Sweden; 2004: Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia; 2007: Bulgaria, Romania.

⁶ Originally taken from Article 2 of the Convention of 8 April 1904 between France and Great Britain and well-known in U.S. constitutional law as “the doctrine of the equality of states.”

⁷ Europe 2020 is the EU’s growth and structural policy strategy.

embark on difficult reforms and to overcome the vested interests of powerful groups in applicant countries. However, experience has shown that conditionality is best fulfilled when combined with program money supplied by the IMF and by macrofinancial assistance from the EU.

We present a description of the EU accession road map defined for the purpose of this article (adapted from Cermak and Lindner, 2012) in box 1.

Box 1

Road Map for the Integration of Applicant Countries^{1,2}

Potential Candidate Country

The implementation of the **Stabilisation and Association Agreement (SAA)** provides a framework for dialogue and future negotiations: Individual Progress Reports outline political and economic reforms necessary to apply for EU membership. A country that does not fulfill certain baseline conditions laid down in the progress report should not apply, as it will be refused candidate status.

The **application for membership** is sent to the EU Council, which requests the European Commission (the Commission) to prepare a report (opinion, or “avis”).

- To prepare the report, the Commission sends a (very comprehensive) questionnaire to the applying country.
- On the basis of the report, the EU Council decides unanimously whether to confer the status of candidate country on the applicant country or not, and when to open negotiations with the country.

Candidate Country

For each candidate country, the EU determines a **negotiating framework** that establishes the general guidelines and conditions for accession negotiations. The Commission may start the screening process (see below) even with a candidate country.

Candidate Country with Opened Negotiations

Before starting negotiations in substance, the Commission conducts a detailed **screening process**. Each of the 35 negotiation chapters is screened separately, but in parallel:

- **Step 1:** Presentation and explanation of EU legislation (the *acquis*)
- **Step 2:** Examination and comparison of national legislation with the entire EU *acquis*
- The goal for the candidate country is to understand the *acquis* and its implications for national legislation (harmonization, transposition and implementation) and for the Commission to ascertain how far the country already meets membership requirements and what needs to be done.
- Some **intermediate screening stages** could be considered if the Commission identifies further issues that need to be addressed. For example, the Commission evaluates a country's national legislation harmonization with the *acquis* and finds that it has to be improved. In a next step, the Commission circulates a draft report on the factual part of the intermediate screening exercise to the candidate country (usually, the Ministry for European Integration) for feedback.

¹ The authors gratefully acknowledge valuable comments on a previous version of this box by Franz Cermak (European Commission, DG Enlargement).

² See also, for instance, European Commission (2002).

- The Commission completes a **screening report** which assesses the country's state of preparedness and gives a recommendation to the EU Council on whether to open negotiations on a certain chapter or whether to require that certain conditions (**opening benchmarks**) be met first. If opening benchmarks are established for certain chapters, a candidate country has to develop and implement an action plan before a negotiation chapter is opened.

Based on the Commission's recommendation, the EU Council unanimously decides whether to **open chapters of negotiation** or not.

Negotiations take place in a format of intergovernmental conferences (EU Member States: permanent representatives in Brussels; candidate country: ambassador or chief negotiator).

- Negotiations are based on the candidate country's adoption, implementation and enforcement of the acquis. For candidate countries, it is essentially a matter of agreeing on how and when to adopt and implement the EU rules and procedures. For the EU, it is important to obtain guarantees on the date and effectiveness of each candidate country's alignment with the relevant part of the acquis. Negotiations also cover financial arrangements as well as possible transitional arrangements requested either by the Member States or by the candidate country.
- Negotiations are conducted individually, based on the merits of each applicant country. The acquis is not negotiable.
- On the basis of the screening report and the opening benchmarks, the applicant country drafts a **negotiating position** for each negotiating chapter outlining problems in aligning with the existing acquis and proposing solutions to be negotiated. Based on the negotiating position of the candidate country, the Commission prepares a so-called draft negotiating position consisting of a request for further information, of the EU position on special negotiation conditions (i.e. derogations, temporary exemptions or safeguard measures, transition periods, etc. requested either by the applicant country or a Member State) and of benchmarks for closure. To avoid competitive advantages, derogations or transition phases are very rarely granted. The applicant country usually has to find solutions at the national level for any such issue.
- The duration of negotiations can vary, depending on each candidate country's correct transposition and implementation of the acquis.
- **Closure of a chapter of negotiations** (provisional closure) occurs when the EU Council unanimously agrees on the EU common positions, which are based on the Commission's draft common position. Closure demonstrates a high level of alignment with the acquis, fulfillment of the benchmarks and agreement on transition of measures. However, "Nothing is agreed until everything is agreed" to ensure the irreversibility of the process in all areas and full and effective implementation of the acquis.
- Progress is closely monitored by the Commission and reported to the EU Council. This implies that the negotiation chapters are closed provisionally and can be reopened in case a candidate country deviates e.g. from agreed implementation of the acquis.

Acceding Country

Once overall agreement has been reached, the **Accession Treaty** (including accession date, transition measures, etc.) is drafted. The Accession Treaty is subject to approval by the EU Council and has to be ratified by the national parliaments of all EU Member States and by the European Parliament.

- Until accession, the Commission keeps the EU Council and the European Parliament informed about the candidate country's status through regular communications and reports ("Regular Reports" and "Enlargement Strategy"). It monitors fulfillment of benchmark requirements and progress in applying the EU legislation, gives additional guidance about responsibilities of membership, and offers guarantees to the current Member States that the future Member State is meeting the conditions for accession.
- Once the Accession Treaty has been signed, the acceding country is given **observer status** (no speaking or voting rights) in the EU and ESCB Committees to enable it to prepare well for participation.

2.2 EU Accession – How Is It Done at the National Central Bank Level?

By and large, the above road map also represents the accession framework for any NCB. What are the specific tasks conferred upon NCBs in the different accession phases of the road map?

Typically, within the EU screening and negotiation framework, NCBs are either responsible for and/or have the co-competence for negotiating chapters like economic criteria, economic and monetary union, financial services, the free movement of capital, statistics or institutions. Their partners in this are usually the Ministry of Finance (MoF) and/or a special Ministry or Secretariat of European Integration.

We describe a general framework or road map that an acceding NCB (Central Bank of Bosnia and Herzegovina, 2011b) might use to consistently meet the accession criteria and to minimize time constraints once the process of negotiation really starts. Our intention is to present a possible guideline for central bank management to conduct constructive discussions with the European counterparts. Thus, an NCB should be aware of the following instruments of the Commission, the ECB and at the national level that put its institutional and operational capacity of implementation under scrutiny.

2.2.1 Pre-Accession Economic Programme (PEP)

PEPs are important for the candidate countries to develop and communicate consistent economic, monetary, fiscal and structural policies over the medium to long term. They comprise a macroeconomic scenario, a fiscal framework and a structural reform agenda. PEP preparation serves to strengthen the economic planning capacity in a country and to meet the Copenhagen economic criteria for accession, i.e. establishing a functioning market economy and raising competitiveness to a level that allows countries to meet competitive pressure in the EU (European Commission, 2011a).

The Ecofin Council of November 26 to 27, 2000, initiated the so-called Pre-Accession Fiscal Surveillance Procedure, which aims at preparing countries for participation in the multilateral surveillance and economic policy coordination procedures currently in place in Economic and Monetary Union (EMU). The Commission invites candidate countries to submit PEPs.⁸ The PEPs and their assessments are discussed in the framework of the Economic and Financial Committee (EFC) with MoF and NCB representatives⁹ from candidate countries. The process ends with an annual policy dialogue of the Ecofin Council with candidate countries. Eurostat and the ECB present a joint progress report on the Action Plan on Economic, Monetary and Financial Statistics. Also, the ECB contributes a note reviewing in particular monetary and exchange rate policies and financial stability.

How can an NCB make a positive contribution? An NCB can fulfill a useful role by contributing realistic input for its country's PEP, i.e. information about the macro framework, monetary and exchange rate policy, structural reform areas such as the financial sector and statistics; it could also remind the government to

⁸ Potential candidate countries are invited to submit Economic and Fiscal Programmes (EFPs).

⁹ Invitations are usually sent to the Ministries of Finance, which are supposed to transmit them to their NCBs.

adhere to the principles of fiscal soundness enshrined in the EU Treaty. However, NCBs have to refrain from writing the fiscal notifications for their country, as this task will fall strictly on the MoF once the country is in the EU.

2.2.2 National EU Coordination Platform

The EU coordination platform at the national level is usually the common framework for policy dialogue and institutional coordination within a country. It is part of a deep institutional reform process instigated at the level of public institutions. This platform could be used as the main counterpart of the Commission in accession negotiations. Based on our experience, this platform may differ from one country to another with respect to its mandate, size, leadership, composition and operating procedures. We have noted that such platforms have no impact on the independence, formal responsibilities and position of NCBs in relation to the government or/and other political institutions (such as the parliament):

- NCBs' participation in such an institutional platform depends on the tasks a central bank decides to fulfill and the role it decides to play in enlargement in its interaction with other institutions, especially with MoFs. This might be either an advisory role (keeping a low profile among national authorities) or a proactive role (acting as a key player and mover).
- An EU mandate (National Bank of Poland, 2003) should be properly designed and given to an NCB board member to represent the NCB's interest in national and international meetings. Many NCBs in the ESCB have built up and developed a strong relationship with their correspondent MoFs, without prejudice to their independence, for joint or consultative decision-making on chapters of common interest such as EMU, capital movements, financial services, statistics, etc.

2.2.3 Technical Assistance for Reform

NCBs may be involved in technical assistance projects. In its 2007 to 2013 budget, the EU has provided technical assistance for reforms such as the fight against corruption, the development of the public and private sector as well as social development in the form of EUR 11.6 billion of Pre-Accession Assistance (Instrument for Pre-Accession Assistance, IPA). The Commission (2011b) notes that technical assistance for accession in the areas of economic planning, institution and capacity building, and implementation has proven powerful. This promotes cooperation and best practices between Member States and candidate countries. The IMF (Arezki et al., 2012) found that training leads to an increase in structural reforms, through IMF programs, but only when a significant share of civil servants is trained. Moreover, large-scale training provides a tool to reconcile conditionality – also typically associated with Stabilisation and Association Agreements – with higher policy ownership in the candidate countries. A case in point are technical assistance projects conducted by ESCB NCBs and coordinated by the ECB. Technical assistance projects successfully carried out in the last five years for a number of central banks from the Western Balkan countries (e.g. the Republic of Serbia, Montenegro, Bosnia and Herzegovina, and the Former Yugoslav Republic of Macedonia) have covered areas like statistics, EU integration, financial stability, supervision, and economics. NCBs are well advised to use the means put at their disposal by the EU budget (and also the IMF) to continue to build professional and credible institutions.

2.2.4 Formal Bilateral Contacts with the ECB

For former candidate countries, formal bilateral contacts with the ECB started only after accession negotiations had been closed. They took the format of annual high-level meetings at which the ECB contributed an assessment of monetary and exchange rate policies. This institutional dialogue was based on questions and answers on macrofinancial developments and central banking governance, which could be followed up by special topics at the expert level. However, in the last few years, an informal contact with the ECB was initiated earlier through technical assistance programs coordinated by the ECB in various areas. In addition, the International Relations Committee of the ESCB holds a yearly briefing on candidate and potential candidate countries in which, however, candidate countries' NCBs do not participate. For acceding NCBs, the ECB draws up an EU Enlargement Master Plan, which aims at preparing an NCB for participation in the ESCB. The acceding NCB is requested to work alongside the ECB and NCBs of the ESCB on the implementation of master plan activities in the area of monetary policy and instruments, asset management, statistics, accounting, payment systems, introduction to ESCB document management, etc.

In box 2, we present an NCB road map for integration based on NCB experience gained at different stages of accession. The road map focuses on internal decisions to be taken by the NCBs (Mihailovici, 2012).

Box 2

Road Map for Integration of Applicant Countries' NCBs

Defining an Accession Strategy

- *EU integration is defined as a top priority in an NCB's general strategy.*
- *A central bank accession strategy (Banca Națională a României, 2003) that is derived either from the national accession strategy or that is drawn up as an internal independent document should help the bank to strengthen its governance and to implement the requested reforms.*
- *The accession strategy is implemented through an action plan detailing principles as well as short- and medium-term NCB priorities.*
- *To reduce the risk of inertia, an EU Scenario Process is introduced as a management tool.*

Establishing an Internal EU Coordination Mechanism

- *An **EU coordination mechanism at the central bank level** is a body (usually a working group) for policy and institutional coordination on EU matters within the bank. Its members include senior managers and/or some members of the management board representing different departments of the bank involved in the preparation of EU accession. The legal department and the international department (usually the internal EU coordinator) are always represented, as they have to deal with horizontal EU issues throughout preaccession.*
- *This coordination mechanism should meaningfully contribute to screening a vast amount of economic, financial and monetary information for accession preparation and should help build a consensus on EU matters for decision-making in the NCB's management board.*

Establishing an Internal EU Coordinator

- *In general, the tasks and functions of international departments are correlated with a country's relevant phase of EU integration (Central Bank of Bosnia and Herzegovina, 2010).*
- *The framework for conducting international relations in a central bank is quite diverse and can create problems of coordination and leadership, such as unwanted duplication of interactions or overlaps of tasks and activities. To avoid such unwanted duplication, it is best to define clear guidelines for coordination in preaccession (Central Bank of Bosnia and Herzegovina, 2011a), whose implementation is effectively supported by top management.*
- *ESCB best practices suggest appointing a **division as EU coordinator** (either in the governor's office or the international department). Furthermore, the BIS central bank governance group (Bank for International Settlements, 2009) proposes to recognize that international relationships are usually a significant element of the governor's role and should be under his leadership.*
- *The EU coordinator focuses on institutional and interdepartmental interaction, coordinating line departments involved in preparing consolidated versions of key EU-relevant documents, which are then submitted to the NCB management board for approval. This coordinator also acts as a "secretary general" for the internal EU coordination platform.*

3 Developing Central Bank Governance in Accession

3.1 Theoretical Delimitation

The academic literature mainly of the past three decades in the field of political science has unanimously recognized that there is no clear and universally accepted definition of "governance." Many attempts at a definition have been made; however, all have failed to reach a consensus. After a close examination of several authors (Stoker, 1998; Kaufman, 1999; Bell, 2002; Kooiman, 2003; The United Nations Committee of Experts on Public Administration of the United Nations Economic and Social Council, 2006), we chose to use the general definition of the concept of "governance," i.e. a multifaceted conceptualization of the interrelation between the state and society from several perspectives, namely the economic, legal, institutional and operational perspectives. In a next step, for the purpose of our article, we combined this definition with the concept of "good governance" defined as a "number of pillars laying down the legal framework governing a central bank: independence, transparency and accountability" (Amtenbrik, 2005). However, to address larger issues like the impact of the policy of EU coordination on the central bank governance of an NCB in accession, we focus our analysis also on the institutional and operational components of good central bank governance. This "means that the objectives and tasks delegated to an institution are performed effectively and efficiently, thus avoiding misuse of resources, which is crucial for establishing a good track record" (Lybek and Morris, 2004). For this case, we define external and internal governance mechanisms that focus on ensuring that the NCB resources are used efficiently and effectively.

3.2 Good Governance: Economic, Legal and Institutional Requirements

The good governance concept also applies to issues such as the overarching goals of price stability and financial stability. For the candidate country's NCB, it is relatively easy to follow the model laid down in the EU Treaty and the Statutes of the ESCB: independence and accountability combined with a stability-oriented

monetary policy. Conversely, a central bank that is not independent but that operates more or less as a branch of the Treasury tends to be called on to exert functions ancillary to the budgetary process rather than to the monetary management process (Padoa-Schioppa, 2005). Successor states of the former Socialist Federal Republic of Yugoslavia very often had to rebuild their NCBs from scratch. At the outset of the reforms, many SEE countries adopted new central bank laws, giving central banks a high degree of independence at least *de jure*. Therefore, aligning central bank legislation to EU levels remains a top priority for the NCBs of candidate and potential candidate countries during accession. Its correct implementation will also be seen as a measure of institutional maturity for EU membership. The Commission (2012a, 2012b) reported immediately that amendments to the Law on the National Bank of Serbia adopted in August 2012 seriously challenged the NCB's independence, undermining confidence in monetary policy, and that special attention must be paid to such developments. On November 5, 2012, the Serbian parliament adopted amendments to the central bank law which aligned the NBS statute with the provisions of the EU treaties and the Statute of the ESCB and the ECB.

Among the convergence criteria, inflation and exchange rates fall within the scope of responsibility of NCBs. In the past, it was often suggested that a country should not worry too much about fulfilling the Maastricht criteria before entering the EU. However, accession countries might be well advised to pay heed to the guiding role of the Maastricht convergence criteria and to check up on their fulfillment in the framework of their countries' macroeconomic policy (Pöder, 2005).

The Commission encourages enlargement countries to associate to the Europe 2020 strategy, as it provides a useful anchor for reform. The Europe 2020 objectives are reflected in the dialogue on economic policy between the Commission and enlargement countries and in the programming of financial assistance. International financial institutions also take these objectives into account, which can be very relevant once a candidate country is in need of an IMF program. The ongoing debt crisis has underlined the importance of sound public finances, and the Commission already uses the peer review mechanism of the EU for candidate countries. From the NCBs' point of view, early familiarization with the economic governance mechanism of the EU is therefore essential. The OeNB's experience shows that economic, legal and institutional challenges are best met by a consistent longer-term approach (Dvorsky and Lindner, 2005).

NCBs in the various stages of accession and also in the first years as ESCB members tend to be confronted with the need to review and change objectives, tasks and functions. When Croatia began its accession negotiations, the Croatian National Bank had just established an EU Division (as an internal EU coordinator) and had restructured its banking supervision operations; market operations had just been introduced as a new monetary policy instrument. Within the framework of the Stabilisation and Association Agreement, Croatia had been taking further steps to liberalize capital transactions (Matejka, 2005). The NCBs of acceding countries focused on restructuring their internal activities – including their core competences, i.e. monetary and exchange rate policy – closing branches, improving internal communication, adjusting payments systems. New ESCB members usually found it difficult to deal with the additional workload coming from participation in ESCB and EU committees and from coordination in general.

3.3 Policy of Coordination in Accession

Starting from this good governance approach, we would like to emphasize the importance of expanding and deepening the concept of central bank governance in the area of coordination, which functions as a strategic tool of change management during accession. We propose a new type of governance in a central bank in accession, namely a pluralistic and heterarchical dialogue (Jessop, 2000; Lee, 2003). In practice, this new coordination policy has two levels:

- External governance: This refers to the national and EU level, where a set of institutions and actors work together to reach the same goal, i.e. the country's accession to the EU.
- Internal governance: This refers to the central bank level, where communication flows freely among departments and actors and where departments work together across organizational divisions and hierarchies, setting up interorganizational networks, and where the division of labor and responsibilities is clearly organized.

Table 1 gives an overview of governance issues and the main elements relevant for NCBs in accession.

Table 1

Central Bank Governance in Accession – Key Challenges

Good Governance	External Governance	Internal Governance
NCB independence, transparency, accountability	Participation in the EU coordination platform EU mandate	Accession as a priority for the NCB's strategy based on road map
Price stability and financial stability Convergence criteria Europe 2020	Participation in various committees under the SAA and during EU negotiations	EU coordination mechanism EU coordinator Guidelines for coordination EU Scenario Process
	Coordination	
	Communication	

Source: Authors' compilation.

3.4 External Governance of a Central Bank in Accession

In most of the cases examined by the authors, an EU coordination platform was the common institutional framework under which central banks operated at the national level to participate in the accession process. The design of an EU coordination platform can be quite simple, though different from one country to another. Most of these EU coordination platforms work as a high-level multifunctional framework, with subcommittees very often reflecting the negotiation chapters and the SAA.

As already mentioned in section 2.2, when a central bank in accession is involved in such institutional arrangements, its management board has to decide, even before starting negotiations, what role it would like to play in accession and how it can establish itself as a source of confidence and prestige at the national and international levels (Popa, 2005). Thus, reputational risk plays a key role in EU decision-making processes on EU and ESCB issues. Many NCBs have taken accession as an opportunity to develop more mature and sophisticated policy tools; in particular, we refer to what political science defines today as “soft power” (Nye,

1990, 2004; Babb, 2008), meaning a power which “lies in the ability to attract and persuade” (Nye, 2004) involving more intangible forms of influence through cooperation and dialogue, derived from national cultural dimensions in organizations (Hofstede et al., 2010). The level of engagement of an NCB in consultation, cooperation and coordination with other national or EU institutions can to a certain extent influence the success or failure of e.g. the macroeconomic dialogue with the EU counterparts at different stages of accession. The Government of Romania (2001), for example, used a National Programme for Accession to the EU to monitor the implementation of priorities set by PEPs in combination with an EU Accession Partnership at the national level. A National Action Plan based on the Stabilisation and Association Agreement, setting out short- and medium-term priorities to implement requested reforms, can also serve as an orientation line for the NCB in order to fulfill its specific tasks.

3.5 Internal Governance of a Central Bank in Accession

On the basis of an ambitious strategy, EU accession and the related Action Plan, e.g. about the transposition of legal acts or on training and capacity building, become a top priority of an NCB’s multiannual general strategy. We saw that once the accession process approaches, an acceding central bank starts a process of coordination and cooperation inside the bank. The central bank is expected to define and prioritize objectives, tasks and functions and to be sufficiently committed to achieving them. A policy of coordination becomes effective within this context when needs and priorities are correctly identified and addressed and when they are properly managed within an appropriate internal institutional framework as described in box 2.

The bank’s management is well advised to carefully consider reputational and business risks arising in the different phases of accession. Also, the “risk of doing nothing” should not be underrated. An EU Scenario Process involving management, the EU coordination mechanism and the EU coordinator reduces the risk that a sluggish adjustment of NCB governance lags behind rapid policy change. The EU accession strategy usually develops a longer-term view of accession preparations, both in considering the dynamics of the process at the national and EU levels, and in looking forward in time to when to adopt which integration decisions. An EU mandate for the management board (or delegated to a management board member) combined with a permanent institutional setting such as an internal EU coordination mechanism represents an effective and durable integration structure. This structure ensures an NCB-wide medium- to long-term permanent implementation of the Action Plan and, eventually, strong internal institutional and operational governance.

The institutional framework for conducting EU affairs and international relations at an NCB can create problems of coordination and leadership, such as unwanted duplications of interactions or overlaps of tasks and activities (see box 2). Drawing up a guideline for EU coordination of an NCB in accession (Central Bank of Bosnia and Herzegovina, 2011a) could help avoid such problems. It is a combination of tools and procedures that could support the governor and board members in managing EU accession on a day-to-day basis. Ideally, the EU coordinator (EU division or department) and a guideline for EU coordination are set up before the screening process starts.

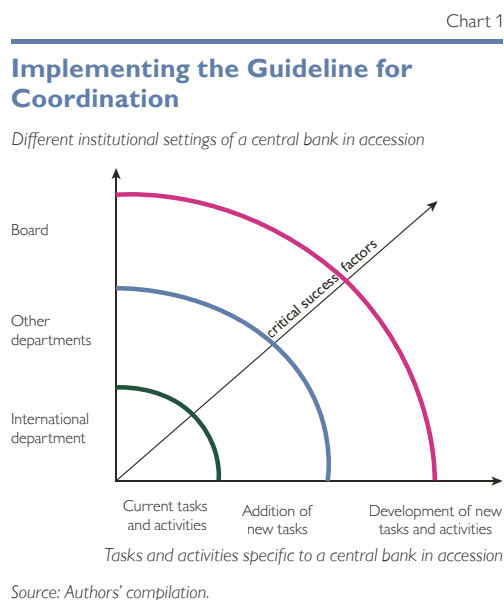
We have identified a set of factors considered to be critical for successful internal management of accession that should be covered by a guideline:

- The NCB should ensure a clear division of labor inside the EU department and vis-à-vis other departments that reflects the position of the EU department as the central coordination point.
- During accession, the EU department serves as a central point of entry for all EU issues from the outside, i.e. the national EU platform, the MoF, etc.
- The NCB should establish a system of regular reporting to and debriefing by NCB management. EU communication inside the NCB is effective when it flows freely across hierarchies and departments.
- The NCB should build and keep track of a network of international and European contacts (also at the technical level) with the European Commission (DG Enlargement and DG ECFIN), the ECB and ESCB central banks.
- Integration work is efficient when tasks are prioritized by management, resources are allocated according to tasks, the EU department's role is acknowledged inside the NCB, there is a good institutional knowledge of the EU/ESCB/Eurosystem and of international financial institutions, there is a suitable IT infrastructure, and when a document management system is in place.

3.6 Coordination and the Ansoff Growth Matrix

To prove that the policy of coordination and its tools have to be at the core of central banking internal governance during the whole accession process, we combine it with the classic diagram of Ansoff's binary choice of old versus new for identifying corporate growth opportunities. This diagram is a strategic management tool developed for a business strategy framework (Ansoff 1957, 2012)¹⁰; it has been moved forward to the macroeconomic level. Basically, we have rethought the policy of coordination in the strategic context of accession, demonstrating that the new tasks and activities specific to a central bank in accession (on the x-axis) and its appropriate institutional settings (on the y-axis) are a matter of degree, and that only an efficient policy of coordination with an NCB leads to effective central banking governance, as illustrated in chart 1, and as a consequence, to growth or development opportunities.

In phase 1 (green line), the international department (i.e. future EU coordinator) is in charge of its regular tasks and activities.



¹⁰ Ansoff (1957) developed the framework for identifying corporate growth opportunities. The Ansoff growth matrix assists organizations in mapping strategic product market growth. Put simply, in Ansoff's matrix, there are always new markets for new products. However, the greater the degree of newness is, the greater the risk assumed is, because both products and markets are new and unknown.

Once the accession process starts in phase 2 (blue line), new tasks are given to both the EU coordinator and line departments, such as (1) coordination of EU issues, namely coordination of positions with external institutions; (2) preparation of documents, reports, analyses on EU/ESCB/Eurosystem issues relevant to the NCB, or preparation of draft documents and consolidated versions of documents related to accession; (3) networking and communication inside and outside the bank; and (4) EU document management. The central bank's management board leads the overall process of coordination, passes on relevant EU documents and takes initiatives in the context of accession.

At all stages of accession and EU membership in phase 3 (red line), management discusses and adopts the NCB's strategic framework (the EU strategy) and supervises its implementation, based on an EU mandate for the management board member in charge of the accession process and on the work of an internal EU working group.

3.7 NCBs' Capacity Building and Training for Accession and EU Membership

The preparations for EU membership create training as well as capacity-building challenges for SEE central banks, as the NCBs are progressively required to perform additional functions during the accession process. Moreover, strengthening the skills, competences and abilities of a critical mass of central bank officials may help foster a collective culture of reform (Arezki et al., 2012) for EU membership and, as mentioned before, NCB "ownership" of reforms.

Analysis and know-how requirements increase because many topics that central bank staff has to deal with are new or at least relatively unknown, i.e. the *acquis communautaire*. During accession, staff and management have to participate in various EU committee meetings and have to present and explain their countries' economic and monetary policy to EU officials on a regular basis. Central bank staff has to prepare issues notes, which are requested by EU officials, to explain legal, monetary or statistical issues. These texts should be well structured and to the point. The need to harmonize numerous national laws with EU requirements within a relatively short time raises questions of quality control, e.g. regarding the translation of legal texts (Dvorsky, 2009). If acceding NCBs do not meet the training requirements, they might not withstand the quality and competitive pressure in the ESCB. For example, the OeNB's cooperation with the ECB and other NCBs in the ESCB has also brought about significant pressure in terms of quality and competition as a result of ongoing changes and adaptation requirements (Dvorsky and Lindner, 2005).

What type of training and skills are necessary to meet the needs for EU accession preparatory work? Horizontal skills to be trained include English language skills, especially for legal staff, negotiation skills, and the ability to write texts of a quality expected in Brussels or Frankfurt. These soft skills, inter alia, will be decisive for the reputation and credibility of a central bank as a future member of the ESCB. International networking is an important feature for successful NCBs. ESCB projects can be turned into useful vehicles, as ECB and ESCB experts work side by side with the beneficiary NCB's staff.

To transfer technical know-how and to introduce EU/ESCB standards progressively to a candidate country's NCB, it is again most effective to work closely together with EU NCBs in the framework of technical assistance projects.

This is an enormous new opportunity granted to SEE central banks in accession, and one that was not yet in place for the former Central and Eastern European candidate countries. However, these countries benefited from large-scale twinning programs: Bulgaria and Romania, for example, received technical assistance in the form of two consecutive two-year twinning programs from a consortium led by the Banque de France and including the Banca d'Italia and De Nederlandsche Bank (European Central Bank, 2008). This sort of technical assistance, starting ideally with an assessment of needs, can come up with solutions tailor-made for the individual central bank. Requirements shift during the phases of accession between general topics of economic policymaking and, for example, human resource development for integration, the application of new statistical methods, or the development of IT tools. Such technical assistance programs have to be well anchored in an NCB's EU preaccession strategy and in its priorities for action. For management, these programs can function as an adjustment tool to continuously and permanently implement EU standards. A separate post-project surveillance can contribute to achieving sustainability.

3.8 NCBs' Communication on EU Issues

Public support plays a key role in a successful accession process, also for popular acceptance of necessary economic and political reforms. In the eyes of the Commission (European Commission, 2011b), the national, regional and local authorities of the enlargement countries have an important role in information and communication. This is a big challenge for NCBs endeavoring to facilitate an informed public debate on EU accession in their field of competence. In general, information provided by NCBs enjoys a good measure of credibility with the public. Therefore, information policy should be viewed as a new and permanent task for an NCB and its public relations department. Setting EU communication as a priority in the EU preaccession strategy and in the action plan of an NCB aims at “translating what is done in Brussels (and Frankfurt) into language which can be used outside Brussels (and Frankfurt)” (Judge and Earnshaw, 2008). Internally, effective EU communication could refer to (1) coordinating, integrating and synchronizing EU communication responsibilities and resources inside the bank and among all departments involved in the process, (2) linking it with the internal EU coordinator and (3) streamlining the operational flow of information to provide for permanent and consistent communication.

4 Conclusions

On average, EU accession will take longer than in earlier accession rounds, and there will not be any “discounted” memberships. Based on past experience, the European Commission has reinforced its process of screening and negotiation, operating with benchmarks and stricter surveillance of the implementation of action plans and the *acquis communautaire*. Current candidate and potential candidate countries have more political and economic hurdles to overcome before they can join the EU than the countries before them: On the one hand, this is due to an increase in the *acquis* that applicant countries have to implement, as the density for example of economic and financial integration has risen. On the other hand, many of the current applicant countries still have political issues of the past to solve (e.g. Serbia and the issue of Kosovo). These countries start out with institutions that in

general need more institution and capacity building. Much of the above description also holds for the NCBs of those countries; they will have to take many reform steps outside the ESCB framework.

The NCBs of candidate countries have to keep working on integration in a sustainable way, even in the face of extended preaccession stages and setbacks in accession outside their power of influence. If NCBs do not pursue a consistent path toward good governance by introducing EU standards and best practice, in the medium to long run, they will put their success at very high risk. Based on practical experience, the following risks can be identified:

- Strategic risk, which deals with the decision-making process on EU matters and ultimately with the EU mandate the NCB management board has defined for itself;
- Operational risk, which relates to the policy of coordination inside an NCB and the capacity of the internal EU coordinator to lead credible accession preparatory work. If the management of the NCB neglects to keep up a sense of urgency about EU accession issues, this inertia could lead to high costs and delays at later stages of accession and even during membership; the continuous implementation of an EU Scenario Process is advisable;
- Economic and institutional risk, which relates to a policy of coordination at the national and at the EU level, where networks, know-how and a good reputation are essential for progress in accession. Early familiarization with EU economic governance and application of good governance can help avoid reform jams and thereby economic and institutional risk.

We advocate the idea of building a risk culture inside the NCB that helps keep the right balance of risks. This can be seen as the sum of individual and institutional values, attitudes, competences and behavior that determine the commitment of an NCB to EU integration and ownership of the EU *acquis* relevant for an NCB. Thus, successful acceding NCBs make EU accession a top priority of their strategy, with a policy of coordination at the core, and install an effective EU coordination mechanism and EU coordinator.

The recent crisis serves to remind us that lasting and sustainable convergence requires unabating policy efforts. In this regard, the ECB (European Central Bank, 2012) advocates that membership of the EU should be seen as a means to an end – namely real convergence, stability and prosperity – rather than as objectives in themselves. The challenge lies in upholding a steady reform pace, so that a country and its NCB can participate as an equal member in the concert of the EU. If this challenge is not met, membership will not be possible.

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