Central Bank Independence in Southeastern Europe with a View to Future EU Accession

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The paper provides a qualitative overview on current central bank legislation in Southeastern Europe (SEE), namely Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, and Serbia and Montenegro, and assesses the degree of central bank independence (CBI) already achieved, using the Maastricht Treaty requirements as a yardstick. The following aspects of legal CBI are examined: first, the definition of statutory objectives in central bank laws (functional independence); second, the central banks' independence in the formulation and implementation of monetary policy (institutional independence); third, the legal status of the central bank governor and other members of the highest decision-making body (personal independence). Fourth, the paper examines two aspects of financial independence, namely the budgetary independence of the central bank itself and the prohibition of monetary financing. Fifth, the paper briefly deals with central bank accountability issues. Moreover, selected aspects of actual CBI are analyzed. The paper concludes that the central bank laws already comply with Treaty requirements in some areas, while a considerable number of weaknesses remain. With a view to future EU accession, a further strengthening of both legal and actual CBI will be necessary for the countries to fulfill the requirements of the Maastricht Treaty.

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 toward 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) or in earlier own work (Radzyner and Riesinger,[2] 1997). 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 statutes had to be adapted to the requirements set out in the Maastricht Treaty[3] and the Statute[4]. The European Monetary Institute (EMI), the predecessor of the European Central Bank (ECB), identified a number of provisions in the national central bank 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. Those EU Member States which joined the EU on May 1, 2004, participate in EMU from the date of their accession as "Member

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[2] *The author published this earlier study jointly with Olga Radzyner under the name Riesinger in 1997.*

[3] *Treaty on European Union, referred to as "the Treaty" or "the Maastricht Treaty" (1992) hereinafter.*

[4] *Protocol on the Statute of the European System of Central Banks and of the European Central Bank (1992), referred to as "the Statute" hereinafter.*

States with a derogation." Therefore, Maastricht Treaty requirements in the area of CBI constituted part of the *acquis communautaire*.[5]

The main purpose of this paper is to compare current central bank legislation in Southeastern Europe[6] (SEE), namely Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Romania, and Serbia and Montenegro[7]. Like most transition countries, the SEE countries have implemented comprehensive central bank reforms in the past years; four countries enacted new central bank laws only between 2001 and 2004, while the other laws date back to 1997. All the countries under consideration are either official EU candidate countries or are regarded as potential candidates with a prospect of future EU membership.[8] While Bulgaria and Romania made substantial progress in their accession negotiations and are preparing to join the EU in January 2007, Croatia[9] was granted candidate status in June 2004; the start of accession negotiations is envisaged for early 2005 (Council of the European Union, 2004). Macedonia submitted a formal application for EU membership in March 2004, and a Stabilisation and Association Agreement[10] (SAA) entered into force on April 1, 2004. Negotiations on an SAA between the EU and Albania were launched in early 2003 and are still underway. Bosnia and Herzegovina is working on implementing the priority areas identified in the Commission's Feasibility Report of November 2003. Serbia and Montenegro has made progress toward a closer relationship with the EU through the adoption of the Constitutional Charter and an internal market and trade action plan (European Commission, 2004a, p. 8).

As the principle of equal treatment will be applied to all new Member States, the SEE countries will join the EU as "Member States with a derogation" and, consequently, 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 current central bank legislation in the SEE countries and to assess the degree of CBI already achieved, using the Treaty requirements as a yardstick.

[5] *If all Member States ratify the Constitutional Treaty of August 2004, regulations on CBI will broadly remain unchanged in substance, but will be even more strongly protected than presently: While the independence of the ECB will be explicitly enshrined in the Constitution in Article I-30, the status of the NCBs will be regulated in Part III, Articles III-185 to III-191 (see Conference of the Representatives of the Governments of the Member States, 2004a). Furthermore, the Protocol on the Statute of the ESCB and the ECB is annexed as part and parcel of the Constitutional Treaty.*

[6] *The countries are given in alphabetical order.*

[7] *Since February 2003, Serbia and Montenegro have temporarily formed a state union, replacing the earlier Federal Republic of Yugoslavia. According to Article 14 of the Constitutional Charter (2003), Serbia and Montenegro are a single legal person in international law and one member of international organizations. Furthermore, Article 13 of the Law on the Implementation of the Constitutional Charter (2003) stipulates that Narodna banka Srbije (the National Bank of Serbia; this designation will be used hereinafter) is the legal successor of the National Bank of Yugoslavia and continues to operate on the territory of Serbia, with the Serbian dinar as the official currency. Therefore, this paper will deal with the independence of the National Bank of Serbia and refrain from treating the status of Centralna banka Crne Gore (the Central Bank of Montenegro; this designation will be used hereinafter) separately. Montenegro has unilaterally adopted the euro.*

[8] *This objective was endorsed by the European Council in Feira and reconfirmed by the European Council in Thessaloniki in June 2003 (European Commission, 2004b).*

[9] *Croatia signed a Stabilisation and Association Agreement with the EU in October 2001; the ratification process has not yet been completed.*

[10] *This was the first Stabilisation and Association Agreement to enter into force in the Western Balkans.*

The paper is organized as follows: Section 2 provides a brief literature overview on CBI in transition countries. Section 3 compares current central bank legislation in SEE. Section 4 examines selected aspects of actual CBI. Section 5 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). 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 five out of seven SEE countries are included in the country sample analyzed by Cukierman et al. (2000), none of the five central bank laws currently in force was examined. In a similar vein, Maliszewski (2000) presents data on 20 Central and Eastern European (CEE) transition countries. The author constructs 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 laws are highly significant in explaining inflation rates. Maliszewski's paper covers four of the seven SEE countries, but measurement is made on legislation not in force anymore. Dvorsky (2000) measures the degree of legal and actual CBI in five CEE 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 Maastricht 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. Freytag (2003) analyzes the state of legal CBI in selected transition countries by constructing 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.

3 Comparing Legal Central Bank Independence in Southeastern Europe

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.[11] For Albania, Bosnia and Herzegovina, Macedonia, and Serbia and Montenegro, the Annual Report on the Stabilisation and Association process for South East Europe by the European Commission provides the only "institutionalized assessment" which examines the countries' readiness to move closer to the EU in a very general manner (European Commission, 2004a). This report does not touch separately upon the issue of CBI. On Croatia, the European Commission produced an Opinion on the country's application to join the EU in April 2004, which deals with the most important aspects of CBI in chapter 11 and examines the country's ability to fulfill the requirements of the *acquis* in the field of EMU in the medium term (European Commission, 2004b). For official candidate countries, the European Commission publishes so-called Progress Reports every year. These reports, which were first published in 1998 on the ten candidate countries at the time, provide an annual update of the Commission's assessment on the candidate countries' preparedness to fulfill 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, treating the issue of legal CBI in chapter 11 on the EMU *acquis*. A detailed analysis of the first Progress Reports with respect to central banking issues can be found in Dvorsky et al. (1998). While the 2004 Progress Reports cover only two of the SEE countries, namely Bulgaria and Romania (European Commission, 2004c, 2004d), Croatia will be included as of next year. After EU accession, national central bank statutes will be examined every second year in the ECB's and the European Commission's convergence reports, an important part of which analyzes in detail the current state of national central bank legislation in Member States with a derogation (ECB, 1998, 2000, 2002, 2004 and European Commission 1998, 2000, 2002, 2004e).

According to Article 109 of the Treaty, new Member States have to adjust their national legislation in the area of CBI in a way that ensures its compatibility with the *acquis* by the date of accession. This provision relates in particular to the independent status of the national central bank (NCB), i.e. the freedom from instructions, a legislated minimum term of five years for the central bank's top officials, the prohibition of monetary financing and the prohibition of privileged access to financial institutions (see Häde, 2002, p. 1373). However, Article 122 (3) of the Treaty stipulates that some Articles of the Treaty do not apply to Member States with a derogation.[12] This provision refers to statutory requirements relating to the full legal integration of an NCB into the Eurosystem, regulating for instance the adjustment of monetary policy instruments, which need only enter into force at the date on which the Member State adopts the single currency.

[11] *Moreover, the Article IV consultations carried out by the International Monetary Fund typically contain a small section on CBI.*

[12] *By analogy, Article 43.1 of the Statute lists Articles which do not apply to Member States with a derogation.*

For comparing and analyzing current central bank legislation in the SEE 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 ECB[13] in the subsequent years and which still provides the analytical framework for the examination of CBI in the 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 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. Interestingly, neither the EMI (nor its successor, the ECB) nor the European Commission have analyzed the prohibition of monetary financing in their past convergence reports.[14] Given the importance of this issue for CBI, it will be included in the definition of financial independence in this paper.

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 the transparency and credibility of monetary policy.[15] However, having a single policy goal does not mean that the central bank can ignore other macroeconomic goals. Therefore, numerous central bank laws as well as the Statute (1992) 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 Maastricht 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." While it cannot be doubted that the primary objective of price stability is binding for all euro area Member States, this is not unambiguously clear for Member States with

[13] *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.

[14] *However, the European Commission's Opinions and Regular Reports on candidate countries do treat this issue when analyzing their ability to join EMU.*

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

a derogation.[16] In its latest convergence report (2004), the ECB takes the view that also the statutes of NCBs of the new Member States should have price stability as the primary objective from the date of their EU accession (ECB, 2004, p. 32).

Table 1

Statutory Objectives and Formulation and Implementation of Monetary Policy

Central bank	Statutory objectives	Formulation and implementation of monetary policy
Bank of Albania	"... to achieve and maintain price stability." (Article 3.1)	"... formulate, adopt and execute the monetary policy" (Article 3.4a) "... formulate, adopt and execute ... the exchange rate policy" (Article 3.4b)
Central Bank of Bosnia and Herzegovina	"... to achieve and maintain stability of the domestic currency..." by applying a currency board arrangement (Article 2.1)	"... to formulate, adopt and control monetary policy by issuing domestic currency at the exchange rate determined in Article 32" (Article 2.3a)
Bulgarian National Bank	"... to contribute to the maintenance of the stability of the national currency..." (Article 2.1)	* detailed definition of currency board regime (Article 28) * fixed exchange rate (Article 29)
Croatian National Bank	"... to achieve and to maintain price stability" (Article 3.1) "... without prejudice to its primary objective, the Bank shall support economic policies ..." (Article 3.2)	"... establish and implement the monetary and foreign exchange policies" (Article 8.1)
National Bank of the Republic of Macedonia	"... to maintain price stability" (Article 3) The Bank shall support economic policy without jeopardizing the main objective (Article 3)	"... establish and conduct the monetary policy" (Article 10) "... determine exchange rate policy" (Article 20)
National Bank of Romania	"... to ensure and maintain price stability" (Article 2.1) "Without prejudice to its primary objective, the NBR shall support general economic policy" (Article 2.3)	"... to define and implement the monetary policy and exchange rate policy" (Article 2.2a) "... define and implement exchange rate policy" (Article 9.1)
National Bank of Serbia	"... achieving and maintaining price stability" (Article 3) "... in addition, ... striving for financial stability" (Article 3) "Without prejudice to its primary objective, the Bank shall support economic policy" (Article 3)	"... determine and implement monetary policy" (Article 4.1) "... determine exchange rate regime with the consent of the government" (Article 4.2)

Sources: Law No. 312 on the Statute of the National Bank of Romania. 2004. June 28.
Law No. 8269 on the Bank of Albania. 1997. December 23.
Law on the Bulgarian National Bank. 1997. June 10.
Law on the Central Bank of Bosnia and Herzegovina. 1997. June 28.
Law on the National Bank of the Republic of Macedonia. 2002.
Law on the National Bank of Serbia. 2003. July 19.
Law on the Croatian National Bank. 2001. April 5.
Compiled by author.
Note: The central banks are referred to by their English designation hereinafter.

In the SEE countries analyzed, most central bank laws contain a clearly defined policy objective for the central bank. Five out of seven laws explicitly refer to "price stability" as the primary objective (see table 1). The central bank laws of Bosnia and Herzegovina and of Bulgaria make reference to the "stability of the domestic/national currency." While the term "currency stability" is generally interpreted as implying the objective of price stability, the EMI argues – in a very strict sense – that this wording does not unambiguously reflect the primacy of maintaining price stability (EMI, 1996, p. 134, on the Austrian central bank statute). Four of the seven SEE central bank laws under consideration provide for a secondary policy objective and contain a stipulation on the support of the general economic policy of the government, without prejudice to the primacy of price stability. In addition to this secondary objective, the Serbian central bank law stipulates that the central bank shall strive for maintaining financial stability. This formulation may carry a potential of conflicting goals for monetary policy, in particular because the primacy of price stability over

[16] *The Convergence Report 2004 identifies an inconsistency in the Treaty: While, according to Article 122 (3) of the Treaty, Article 105 (1) of the Treaty does not apply to Member States with a derogation, Article 2 of the Statute does apply to such Member States.*

this additional objective is not made clear. To sum it up, the statutory objectives as formulated in the central bank laws of Croatia, Macedonia and Romania seem to be largely in line with Treaty requirements, while adaptations will be needed in the other laws.

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 regulations 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 regulations governing the relationship between the central banks and their respective governments, thus covering inter alia institutional independence according the EMI's narrow and Smits' somewhat broader definition. Furthermore, this paper takes an even broader approach and examines whether the seven SEE 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 in the narrow sense defined by the EMI, the freedom from instructions for the central bank is stipulated in all SEE central bank laws under consideration (see table 4, first column). 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, all SEE central bank laws will have to be adapted in order to fully comply with Maastricht criteria in this area.

The need 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 all SEE central banks under consideration are defined as legal entities according to the respective central bank laws.[17] 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 – with

[17] *See Article 1.2 of Law No. 8269 on the Bank of Albania (1997), Article 1.2 of the Law on the Central Bank of Bosnia and Herzegovina (1997), Article 1.1 of the Law on the Bulgarian National Bank (1997), Article 2.3 of the Law on the Croatian National Bank (2001), Article 5 of the Law on the National Bank of the Republic of Macedonia (2002), Article 1.1 of Law No. 312 on the Statute of the National Bank of Romania (2004) and Article 5 of the Law on the National Bank of Serbia (2003).*

the exception of Bulgaria – all central bank laws under consideration do contain such a stipulation.[18]

According to Article 105 (2) of the Maastricht Treaty and Article 3.1 of the Statute, the basic task of the ESCB is the definition and implementation of the monetary policy of the Community. Five of the seven SEE central banks are provided with the formal responsibility to design and implement monetary policy in their countries (see table 1). In Bulgaria and in Bosnia and Herzegovina, the design of monetary policy is determined by the currency board arrangements operated in these countries, which naturally leaves no room for the central banks to independently design the monetary policy regime.

Whether the choice of the exchange rate regime is to 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 economic 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 (see, e.g., Swinburne and Castello-Branco, 1991, p. 40). While the central banks of Albania, Croatia, Macedonia and Romania have the sole competence for determining the exchange rate regime, the National Bank of Serbia has to take these decisions jointly with the government.[19] For Bosnia and Herzegovina and for Bulgaria, this choice is determined by the currency board arrangement (see 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, rules for dismissal, the length of the term of office and the possibility of a renewal of mandate, 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). Another safeguard is to split the responsibility of appointing and that of nominating between, for instance, the government and the state president. 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's Executive Board, these provisions are not comparable to the appointment of NCB officials and therefore, the convergence reports remain silent on national appointment procedures. In the SEE countries, the most common procedure to appoint the central bank governor is the election by parliament, on proposal of

[18] *See Article 1.3 of Law No. 8269 on the Bank of Albania (1997), Article 3 of the Law on the Central Bank of Bosnia and Herzegovina (1997), Article 2.10 of the Law on the Croatian National Bank (2001), Article 4 of the Law on the National Bank of the Republic of Macedonia (2002), Article 1.2 of Law No. 312 on the Statute of the National Bank of Romania (2004) and Article 2 of the Law on the National Bank of Serbia (2003).*

[19] *For a detailed analysis of the exchange rate regimes chosen in SEE, see Barisitz in this issue.*

parliamentary committees (Bulgaria, Croatia, Macedonia, Romania and Serbia; see table 2). In this respect, Bosnia and Herzegovina is a special case, because the central bank governor is appointed by the International Monetary Fund

Table 2

Personal Independence of Central Banks in SEE

Central bank	Governor		Highest decision-making body		Dismissal	Incompatibility clauses
	Term	Appointment	Composition; term	Appointment		
Bank of Albania	* 7 years, reappointment possible (Article 44.4)	* appointed by president of state, on proposal of prime minister (Article 44.2)	* Supervisory Council: Governor, 2 Deputy Governors, 6 other members (Article 44.1) * term: 7 years, reappointment possible (Article 44.4)	* appointed by parliament, 5 members proposed by parliament, 3 by council of ministers, 1 by Supervisory Council (Article 44.2)	* criminal act, bankruptcy, personal misconduct, political activities (Article 47.1) * absence from 2 Supervisory Council meetings, inability to perform, serious misconduct (Article 47.2)	Supervisory Council membership incompatible with appointment/election (Article 46): * president of state * parliament * government
Central Bank of Bosnia and Herzegovina	* 6 years, reappointment possible (Article 8.4)	* appointed by the IMF, after consultation with presidency (Article 8.1)	* Governing Board: Governor, 3 members (Article 8.1) * term: 6 years, reappointment possible (Article 8.4)	* 3 members appointed by the presidency (Article 8.1)	* violation of currency board arrangement rule, criminal act, bankruptcy, personal misconduct (Article 11.1) * inability to perform, absence from more than half of Governing Board meetings in previous year (Article 11.2)	Governing Board membership incompatible with appointment/election (Article 10): * presidency * parliament * Constitutional Court * government
Bulgarian National Bank	* 6 years (Article 12.4)	* elected by parliament (Article 12.1)	* Governing Council: Governor, 3 Deputy Governors, 3 other members (Article 11.1) * term: 6 years (Article 12.4)	* 3 Deputy Governors elected by parliament, through Governor's motion (Article 12.2) * other 3 members appointed by president of state (Article 12.3)	* inability, criminal act, bankruptcy (Article 14.1.2–4) * incompatibility * absence from 3 or more successive Governing Council meetings * serious misconduct (Article 14.2)	* 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 banks, no activity in the executive branch (Article 12.6)
Croatian National Bank	* 6 years (Article 40.6)	* appointed by parliament, on proposal of parliamentary committees (Article 40.1)	* Council: Governor, Deputy Governor and Vice Governors, at most 8 external members (Article 38.1) * term: 6 years (Article 40.6)	* Deputy Governor and Vice Governors appointed by parliament on proposal of Governor (Article 40.3) * external members appointed by parliament (Article 40.4)	* incompatibility * criminal act * serious misconduct * inability to perform * false statements (Article 42)	Council membership incompatible with appointment/election (Article 41) i.a.: * parliament * government * position in commercial banks
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 * inablility (Article 70)	National Bank Council membership incompatible with (Article 58) i.a.: * position in commercial banks * trade union membership * net debtor of a bank status * criminal sentence (waiting time) * party membership
National Bank of Romania	* 5 years, reappointment possible (Article 33.4)	* appointed by parliament, on proposal of parliamentary committees (Article 33.3)	* Board: Governor, Senior Deputy Governor, 2 Deputy Governors, 5 external members (Article 33.2) * term: 5 years, reappointment possible (Article 33.4)	* appointed by parliament, on recommendation of parliamentary committees (Article 33.3)	* inability * serious misconduct (Article 33.6)	Board membership incompatible with appointment/election (Article 34) i.a.: * parliament * political affiliation * public administration
National Bank of Serbia	* 5 years, reappointment possible (Article 16)	* appointed by parliament, on proposal of parliamentary committee (Article 16)	* Monetary Board: Governor, 3 to 5 Vice Governors (Article 13, Article 19)	* Vice Governors appointed by the NBS Council, on proposal of Governor, reappointment possible (Article 19)	* criminal act * incompetence, mistakes * inability to perform functions * false statement (Article 30)	Monetary Board and Council membership incompatible with appointment/election (Article 28) i.a.: * parliament * government * local government * trade union membership * bank management

Sources: See table 1.

(IMF), a regulation which is based on the Dayton Agreement. For the other members of the highest decision-making bodies, in some cases the responsibility for proposing candidates and for appointing members is split (Albania, Bulgaria, Croatia, Macedonia).

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 national central bank 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 current SEE central bank legislation, a wide variety of reasons for dismissal can be found (see table 2): apart from the inability to perform functions and serious misconduct. The legislated reasons include criminal acts, personal bankruptcy, false statements, a ban on practicing the profession or incompetence. In a number of countries, the absence from a certain number of meetings of the highest decision-making body is defined as a reason for dismissal (Albania, Bosnia and Herzegovina, Bulgaria). At the current juncture, none of the SEE central bank laws seem to be compatible with the Treaty requirements in this area. This situation is reflected in the "institutionalized assessment" provided by the European Commission's Progress Reports on Bulgaria and Romania and the Opinion on Croatia. The 2003 and 2004 Progress Reports on Bulgaria demand an alignment of the rules for dismissal and the introduction of provisions for judicial review of dismissal decisions (European Commission, 2003a, p. 70; European Commission, 2004c, p. 80). While the Romanian central bank law is the only SEE law which mostly complies with Treaty requirements, it is, however, criticized by the 2004 Progress Report, which demands an additional amendment in this field.[20]

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, the minimum term of office required for governors of NCBs is established as five years (Article 14.2 of the Statute).[21] 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, all seven SEE central

[20] *The Progress Report on Romania demands that decisions on the dismissal of the central bank's governor should be exclusively referred to the European Court of Justice upon Romania's EU accession (European Commission, 2004d, p. 87). While Article 14.2 of the Statute stipulates that the dismissal of a Governor may be referred to the European Court of Justice, it could be argued that the European Court of Justice's jurisdiction is not an exclusive one.*

[21] *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).*

bank laws analyzed are in line with Treaty requirements (see table 2). Reappointment of central bank governors and, in some cases, even of other top officials, is possible in most SEE countries, while no explicit reference can be found in the central bank laws of Bulgaria and Croatia.

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, a number of SEE central bank laws state required 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, experience in public administration.[22]

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) derives the general principle that membership in a decision-making body involved in the performance of ESCB-related tasks is incompatible with the exercise of other functions which might create a conflict of interest. All seven central bank laws under consideration contain incompatibility rules, which apply to all members of the highest decision-making body (see table 2). Apart from rather common provisions, such as incompatibility with positions in government, parliament, as 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.[23]

Smits (1997, p. 164) criticizes that the Maastricht Treaty and the Statute do not provide for a "cooling-off period" after the term of office has expired that would prevent former members of the ECB's Executive Board from exercising functions with commercial enterprises for a certain period of time. Interestingly, four of the SEE central bank laws do contain such a stipulation.[24]

[22] *See Article 44.3 of Law No. 8269 on the Bank of Albania (1997), Article 8.3 of the Law on the Central Bank of Bosnia and Herzegovina (1997), Article 11.3 of the Law on the Bulgarian National Bank (1997), Article 40.5 of the Law on the Croatian National Bank (2001), Article 58 of the Law on the National Bank of the Republic of Macedonia (2002) and Article 16 of the Law on the National Bank of Serbia (2003).*

[23] *The waiting time is set at five years for sentences of up to three years of imprisonment and at ten years for longer imprisonment.*

[24] *See Article 52 of Law No. 8269 on the Bank of Albania (1997), Article 19.2 of the Law on the Central Bank of Bosnia and Herzegovina (1997), Article 46.1 of the Law on the Croatian National Bank (2001) and Article 33 of the Law on the National Bank of Serbia (2003).*

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 fulfill 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.

Table 3

Financial Independence of Central Banks in SEE

Central bank	Limits to government lending			Budgetary independence	
	Direct credit	Indirect credit	Ownership, management of budget	Allocation of profit	Coverage of potential losses
Bank of Albania	* loans up to maturity of 6 months permitted (Article 30.2) * maximum: 5% of average budgetary revenues of past 3 years (Article 30.4), waiver: 8% of revenues (Article 30.5)	* purchases of government securities in the secondary market permitted (Article 32)	* capital owned by the state (Article 6.3) * budget determined by Supervisory Council (Article 43n)	* 25% of profits allocated to general reserve fund (Article 9) * repayment of previous loss coverage (Article 10.1) * residual profits paid to state budget (Article 10.2)	* net losses covered by Ministry of Finance (Article 7)
Central Bank of Bosnia and Herzegovina	* direct and indirect credit prohibited (Article 67.1)		* budget determined by Governing Board (Article 7j)	* profits allocated to capital account, general reserve and special reserve account (Article 27a to c) * residual paid to fiscal authorities (Article 27d)	* net losses covered by general reserve or to capital account (Article 28) * residual covered by Ministry for Budget (Article 29b)
Bulgarian National Bank	* direct and indirect credit prohibited (Article 45.1)		* approval of annual budget by Governing Council (Article 16.13)	* 25% of profits allocated to reserve fund (Article 8.2) * necessary amounts to be allocated to special funds (Article 8.3) * residual to state budget (Article 8.4)	* losses covered by reserve fund, special fund (Article 9.2) * residual covered by Ministry of Finance (Article 9.1)
Croatian National Bank	* prohibited (Article 36.1)	* purchases of government securities in the secondary market permitted (Article 36.3)	* capital held exclusively by state (Article 50.2) * Council adopts financial plan (Article 38.3b)	* profits allocated to general reserves within defined limits (Article 53.2) * residual to state budget (Article 53.3)	* losses covered by general reserves (Article 53.4) * residual covered by state budget (Article 53.5)
National Bank of the Republic of Macedonia	* prohibited (Article 51)	* purchases of government securities in the secondary market permitted (Article 89)	* sole state ownership (Article 5) * National Bank Council adopts financial plan (Article 64.4)	* 20% of net income allocated to general reserves (Article 86) * residual to state budget (Article 89)	* losses covered by general reserves * residual covered by state budget (Article 89)
National Bank of Romania	* prohibited (Article 6.1 and Article 29.1)	* purchases of government securities in the secondary market permitted (Article 6.3)	* capital owned by state (Article 38.1) * annual budget approved by the Board (Article 41)	* 80% of profit allocated to state budget (Article 43.1) * residual to statutory reserves, own financing sources and employees' profit-sharing scheme (Article 43.5)	* losses covered by special revaluation account and statutory reserves (Article 44)
National Bank of Serbia	* permitted to cover temporary illiquidity of the budget (Article 39.1) * maximum 5% of average budget revenue of past three years (Article 39.2)	* no provision	* Council adopts financial plan (Article 24.1) * Governor decides on use of special reserves (Article 78)	* maximum of 30% of surplus allocated to special reserves * residual to state budget (Article 77)	* losses covered by special reserves * residual covered by state budget (Article 77)

Sources: See table 1.

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 fulfill 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 all seven SEE 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 table 3). Those four SEE central banks where the issue of ownership is explicitly stated in the law (Albania, Croatia, Macedonia and Romania) are owned exclusively by the state. All SEE central bank laws contain detailed provisions regulating the allocation of profits and – this is a related question – the coverage of potential losses: In most cases, 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. Only in Romania is the order of priority an inverse one, with 80% of the profit transferred directly to the state budget and the residual allocated to reserves (see 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. In this context, the Progress Report on Bulgaria criticizes the system of loss coverage in the central bank law (European Commission, 2004c, p. 79): According to Article 9.1 of the Bulgarian central bank law, the Council of Ministers may issue interest-bearing 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 at a later point in time. 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. In a similar vein, the Opinion on Croatia criticizes the provisions on loss coverage through government debt securities (European Commission, 2004b, p. 82): Article 53.6 of the Croatian central bank law stipulates that part of central bank profit – after allocation to reserve funds – has to be used to repurchase such debt securities. Similar provisions on the coverage of losses, which by analogy are not compatible with Treaty requirements either, can be found in the central bank laws of Albania, Macedonia and Serbia.[25]

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

[25] *See Article 7 of Law No. 8269 on the Bank of Albania (1997), Article 89 of the Law on the National Bank of the Republic of Macedonia (2002) and Article 77 of the Law on the National Bank of Serbia (2003).*

by law. Indirect credit, however, such as the acquisition of government securities on the secondary market, is generally not regarded as infringing CBI. 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, 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." Complementarily to the prohibition of direct central bank lending to the government, Article 102 (1) of the Treaty prohibits privileged access of public authorities[26] 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.

Five of the SEE central bank laws analyzed explicitly prohibit direct central bank lending (see table 3). While in the two currency board countries (Bosnia and Herzegovina, Bulgaria) this prohibition also pertains to indirect central bank lending, legislation in Croatia, Macedonia and Romania explicitly allows for purchases of government securities on the secondary market. A peculiarity of the Albanian central bank law has to be noted: Article 30.1 stipulates a general prohibition of direct and indirect central bank financing. This general rule is followed by a number of exceptions and limitations. According to Article 30.4 central bank loans with a maturity of at most six months are permitted up to a maximum amount of 5% of the average budgetary revenues of the past three years.[27] Furthermore, the Albanian central bank law provides for a "temporary waiver" according to which this limit may even be increased to 8% of average budgetary revenues. Moreover, Article 32 permits indirect central bank credit. The Law on the National Bank of Serbia also allows for direct central bank credit to the government to alleviate "temporary illiquidity of the budget" and – like the Albanian law – specifies a maximum amount (see table 3). While the central bank legislation of Albania and Serbia requires major adaptations in the field of prohibition of budgetary financing by the central bank, the five other SEE central bank laws seem to be largely compatible with Maastricht Treaty requirements, with a number of details still to be adjusted to achieve full compatibility. The Progress Report on Romania, for example, 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, 2004d, p. 87).[28] The Progress Report on Bulgaria criticizes Article 45.1 of the central bank law, according to which the central bank may extend direct credit to the government for the pur-

[26] *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.*

[27] *This definition of a maximum amount of central bank lending to the government very much resembles the central bank legislation in Central and Eastern Europe analyzed in Radzyner and Riesinger (1997).*

[28] *In addition, the Commission requires alignment of capital market legislation to prevent privileged access of public authorities to financial institutions (European Commission, 2004d).*

pose of purchasing Special Drawing Rights (SDRs) from the IMF. The Commission demands a safeguard clause which limits this possibility to "obligations" vis-à-vis the IMF (European Commission, 2004c, p. 79).[29] On Croatia, the European Commission's criticism mainly refers to the provisions on loss coverage discussed earlier in this section (European Commission, 2004b, p. 82).[30]

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 (see 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 (see ECB, 2002b, p. 45). While there is ample literature on theory and on 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 mutual participation in meetings, 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. In a number of SEE central bank laws (Albania, Croatia, Serbia), a general notion can be found on the cooperation between the central bank and executive and legislative powers (see table 4). However, the forms and intensity of regulating this cooperation in the respective central bank laws differ widely. A rather loose form of cooperation is the mutual information of central bank officials and politicians. Looking at SEE central bank legislation, only Albanian, Bulgarian and Romanian central bank laws provide for mutual information between the central bank and the government. A slightly more intense form of cooperation is mutual consultation on selected issues, which is stipulated in the central bank law of Bosnia and Herzegovina. 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."[31] Conversely, 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." Four SEE central bank laws (Albania, Macedonia, Romania, Serbia) provide for the participation of the finance minister in the meetings of the highest decision-making body without a right to vote. Interestingly, the Law

[29] *Furthermore, in the area of prohibition of privileged access for public authorities to financial institutions, the Progress Reports demand amendments of the Law on Public Offering of Securities and the Law on Insurance (European Commission, 2004c).*

[30] *Furthermore, in the area of prohibition of privileged access for public authorities to financial institutions, the Opinion calls for adaptations of the Insurance Act and the Act on Mandatory and Voluntary Pension Funds (European Commission, 2004b).*

[31] *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.*

Table 4

Central Bank Accountability in SEE

Central bank	Forms of cooperation with government	Relationship with parliament	Reporting requirements	Publication of minutes
Bank of Albania	* freedom from instruction (Article 1.3) * the Bank shall cooperate with legislative and executive branches of the Republic (Article 24.1) * the Bank shall be consulted on normative acts (Article 24.2) * mutual information (Article 24.4) * Minister of Finance may attend meetings of Supervisory Council, but no right to vote (Article 49.9)	* the Bank is accountable to parliament (Article 2.1)	* policy statement on monetary policy to be delivered to government and parliament every six months (Article 2.2) * the Bank shall prepare and publish periodical analyses on economic and monetary matters (Article 24.3)	* proceedings of Supervisory Council meetings are confidential, publication on decision of Supervisory Council possible (Article 50.1)
Central Bank of Bosnia and Herzegovina	* freedom from instruction (Article 3) * mutual consultation (Articles 52.2, 52.3, 53) * consultation on draft legal acts (Article 65) * the Bank receives information on request (Article 56)	no provision		* proceedings of Governing Board meetings are confidential, publication on decision of Governing Board possible (Article 15.1)
Bulgarian National Bank	* freedom from instruction (Article 44) * mutual information (Article 3)	the Bank shall report its activities before parliament (Article 1.2)	* weekly publication of balance sheet (Article 49.1) * monthly publication of balance sheet (Article 49.2) * the Bank submits two reports a year to parliament (Article 50) * annual report plus financial statement submitted to parliament (Article 51)	no provision
Croatian National Bank	* freedom from instruction (Article 2.10) * cooperation with government in pursuing tasks (Article 5.1) * mutual agreement on planned borrowing between Minister of Finance and central bank (Article 34) * the Bank may express its views on draft decrees and draft laws related to central bank (Article 5.2) * the Bank may propose legal acts to parliament (Article 35)	* Governor has the right to comment on proposed legislation before parliament (Article 35.2) * the Bank shall submit financial statement and information on monetary policy once a year (Article 58.1)	* monthly submission of balance sheet to Ministry of Finance (Article 58.2) * the Bank may publish annually on monetary policy (Article 59.1) * the Bank shall inform the public regularly (Article 59.2)	no provision
National Bank of the Republic of Macedonia	* freedom from instruction (Article 4) * Minister of Finance may attend meetings of National Bank Council, but has no right to vote (Article 63)	* National Bank Council is responsible to parliament (Articles 61, 74) * parliamentary committees meet with Governor at least once every six 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)	no provision
National Bank of Romania	* freedom from instruction (Article 3.1) * central bank may give opinion on draft legal acts (Article 3.2) * central bank cooperates with Ministry of Finance in setting macroeconomic indicators for drafting budget (Article 3.3) * mutual information with public authorities (Article 3.17) * Minister of Finance may participate in meetings of the Bank's Board without a voting right (Article 33.10)	no provision	* annual report to be submitted to parliament (Article 35.4)	no provision
National Bank of Serbia	* freedom from instruction (Article 2) * the Bank shall cooperate with the government … performing its tasks … (Article 10) * mutual participation in meetings (Articles 15, 72) * the Bank may give opinion on draft legal acts (Article 72)	* the Bank shall be accountable to parliament (Article 2) * monetary policy program to parliament (Article 71)	* annual report on operations, monetary policy, banking sector to be submitted to parliament (Article 71)	no provision

Sources: See table 1.

on the National Bank of Serbia (2003) is the only law that also allows for a participation of the central bank governor in meetings held by the government. Furthermore, the central banks of Albania, Croatia, Romania and Serbia are consulted on draft legal acts relating to the central bank's competences. The

Law on the Croatian National Bank (2001) goes even further and gives the central bank the right to propose legal acts to parliament within its field of competence. 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, the National Bank Council, parliament has a final say if the National Bank Council cannot achieve the necessary majority for decision-making. This stipulation can be regarded as infringing CBI rather than as reflecting the central bank's accountability.[32] A more common approach to deal with situations of a tie in the highest decision-making body is to assign a casting vote to the governor.[33]

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 central bank laws in SEE countries, regulations on the relationship between the central bank and parliament largely differ (see table 4). Three laws (Albania, Macedonia, Serbia) contain a general statement that the central bank has a "statutory accountability" to parliament; the Bulgarian law mentions that the central bank "reports to parliament." Only the central bank laws of Croatia, Macedonia and Serbia provide for appearances of the central bank governor before parliament: The Croatian central bank governor has a rather strong role, as he is entitled to comment and explain proposed legislation within the central bank's field of competence. 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 next year. This means a very strong ex ante coordination of monetary policy with parliament, which may jeopardize CBI. Similarly, the Law on the National Bank of Serbia prescribes ex ante coordination on the monetary policy program between the central bank and parliament.

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 charge[34] 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 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,

[32] *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 could well be that the National Bank Council fails to reach agreement, so that in practice, parliament gets the final say.*

[33] *See Article 49.6 of Law No. 8269 on the Bank of Albania (1997), Article 14.7 of the Law on the Central Bank of Bosnia and Herzegovina (1997), Article 39.4 of the Law on the Croatian National Bank (2001), Article 15 of the Law on the National Bank of Serbia (2003).*

[34] *According to Article 15.4 of the Statute, the ECB's publications have to be offered free of charge.*

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 SEE central bank laws, a broad variety of legislated reporting requirements can be found (see table 4): While the Bulgarian, Croatian and Macedonian legislation contain very detailed provisions in this area, the laws of Romania and Serbia oblige the central bank to submit at least an annual report to parliament. The wording of the Albanian central bank law is somewhat unclear on the timing and frequency of required reporting. Only the legislation of Bosnia and Herzegovina remains silent in this area.

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. Five of the seven SEE central bank laws contain no provision on a possible publication of the minutes of the highest decision-making body. Interestingly, the laws of Albania and of Bosnia and Herzegovina largely resemble the stipulation of the Statute in this area (see table 4).

4 Selected Aspects of Actual Central Bank Independence in Southeastern Europe

While the legal status of a central bank provides an important yardstick to assess CBI in a particular country, this is not the only element determining the level of independence of the central bank. There is wide agreement that the implementation of central bank legislation in practice, referred to as "actual CBI," plays an equally important role (see, e.g., Cukierman, 1992, pp. 383–391). In fact, actual CBI may differ substantially from legal CBI, as on the one hand, a number of factors reduce the degree of independence as compared to legal CBI, but on the other hand, there are also examples where actual CBI is higher than legal independence (see below).

While the Maastricht Treaty requirements constitute a set of comparatively clearly defined criteria for the assessment of legal CBI, it is more difficult to provide a systematic judgment of actual CBI in a particular country. Hence, Radzyner and Riesinger (1997, pp. 75–84) used indicators such as the turnover rate of governors, political vulnerability, overriding of the central bank law by budget laws to assess the degree of actual CBI in the CEEC-5. In this section, three aspects of actual CBI which turned out to be the most informative ones for an overall assessment in earlier analysis will be examined: first, the issue of political vulnerability of CBI, second, the turnover rate of central bank governors, and third, the practical implementation of financial independence. However, it is important to emphasize that – unlike the previous sections of this paper – information on actual CBI is based on anecdotal evidence rather than on a systematic monitoring exercise.

4.1 Political Vulnerability

As the central bank law can be changed by a simple majority in parliament in most, if not all countries worldwide, CBI is potentially vulnerable to changes in the political thinking on the independent status of the central bank. Therefore, the frequency of political changes in parliament and, more importantly, the political readiness to reduce CBI by changing the law more or less frequently are very important determinants of CBI in practice.

An illustrative example is the enactment of the new Serbian central bank law, which led to the resignation of central bank governor Mladan Dinkic in July 2003. After protracted political differences with the government, Dinkic had criticized the new central bank legislation for reducing the central bank's independence, for instance by permitting direct central bank credit within certain limits (see section 3.4).[35] Another example in this context is the adoption of the Bulgarian central bank law establishing the currency board regime in 1997, which had to be postponed several times due to a heated parliamentary debate. Only one year earlier, the Bulgarian parliament had passed a highly controversial amendment of the central bank act, which substantially modified the appointment procedures of top central bank officials.

With a view to protecting central banks against this form of political vulnerability, it has been proposed to write the central bank law into the country's constitution (see e.g. Neumann, 1991). However, the mere mentioning of an independent central bank in the constitution is clearly not sufficient to protect the central bank against political vulnerability. A more successful approach to protect CBI is to write the main pillars of CBI into the constitution. At the European Union level, this will be achieved through the ratification of the European draft constitution, which rewrites the provisions on CBI of the Maastricht Treaty and the Statute.[36] Another case in point is the Polish Constitution, which was enacted in 1997 and entailed, with its enactment, fundamental changes in central bank legislation (for details, see Radzyner and Riesinger, 1997, p. 76).

4.2 Turnover Rate of Governors

Although a number of different models to measure legal CBI have been developed up to now (see section 2), it is very difficult to quantify the degree of actual CBI. The best-known approach in this area was taken by Cukierman (1992, p. 383), who introduced the turnover rate of governors as a proxy for actual CBI. The turnover rate of governors is defined as the average term of office of central bank governors in different countries and is calculated by dividing the number of governors within a given period of time by the length of this reference period (expressed in years or fractions of years). In particular for less

[35] *Furthermore, the incompatibility clauses stipulated in the new law prohibit the central bank governor from engaging in party politics. As the deputy head of the G17 Plus political party, which challenges the governing Democratic Party, Mladan Dinkic was forced to make a choice (World Markets Research Centre Limited, July 21, 2003).*

[36] *Amendments of these constitutional provisions require a highly complex procedure and are not easy to achieve in practice: While Part I of the Constitutional Treaty is subject to the regular amendment procedure, which requires an intergovernmental conference plus ratification by all Member States, Part III Title III of the Constitutional Treaty, and thus also the provisions on monetary union, may be amended according to the simplified amendment procedure. Even this "simplified" procedure calls for a unanimous decision of the European Council (heads of government) after consultation of the European Parliament and the Commission and, in the monetary area, the ECB. Furthermore, such a European decision has to be approved by the Member States in accordance with their respective constitutional requirements.*

developed countries, the turnover rate of governors measured by Cukierman (1992, p. 384) proved to be a reasonably good proxy for actual CBI. However, when calculating turnover rates for Central and Eastern European transition economies, results have to be interpreted with great caution: As compared to Cukierman's calculation, which covered almost 40 years, the reference period for this group of countries is extremely short, with a maximum duration of 14 years. Consequently, the results are highly sensitive to changes of both the numerator (i.e. the number of governors) and the denominator (i.e. the length of the observation period). Moreover, the results are critically dependent on whether to include episodes with "acting governors" in the total number of governors counted, and on the definition of the starting point of the observation period.

Table 5

Turnover Rate of Central Bank Governors in Southeastern Europe

	Governors	Reference period	Turnover rate
Albania	* **Ilir Hoti,** May 1992 to September 1993 * **Dylber Vrioni,** September 1993 to December 1994 * **Kristaq Luniku,** December 1994 to April 1997 * **Qamil Tusha,** April 1997 to August 1997 * **Shkëlqim Cani,** August 1997 to September 2004 * **Ardian Fullani,** since October 2004	May 1992 to October 2004	0.48
Bosnia and Herzegovina	* **Peter Nicholl,** since August 1997	August 1997 to October 2004	0.14
Bulgaria	* **Todor Valchev,** January 1991 to January 1996 * **Lyubomir Filipov,** January 1996 to June 1997 * **Svetoslav Gavriiski,** June 1997 to October 2003 * **Ivan Iskrov,** since October 2003	January 1991 to October 2004	0.29
Croatia	* **Ante Cicin-Sain,** January 1992 to October 1993 * **Pero Jurkovic,** October 1993 to April 1996 * **Marko Skreb,** April 1996 to July 2000 * **Zeljko Rohatinski,** since July 2000	January 1992 to October 2004	0.31
Former Yugoslav Republic of Macedonia	* **Borko Stanoevski,** December 1993 to May 1997 * **Ljube Trpeski,** May 1997 to May 2004 * **Petar Gosev,** since May 2004	December 1993 to October 2004	0.27
Romania	* **Mugur Isărescu,** appointed in December 1990 * reappointed in September 1998 * reappointed in September 2004	December 1990 to October 2004	0.07
Serbia and Montenegro	* **Mladjan Dinkic,** November 2000 to July 2003 * **Kori Udovicki,** July 2003 to February 2004 * **Radovan Jelasic,** since February 2004	November 2000 to October 2004	0.75

Note: The cutoff date is October 31, 2004.

Notwithstanding the above-mentioned caveats, table 5 provides an overview of the central bank governors appointed in the SEE countries and presents calculated turnover rates. At the outset, a few methodological remarks are in order: To ensure comparability of results to earlier calculations, approaches taken in Radzyner and Riesinger (1997) and Dvorsky (2000) will be largely retained. First, "acting" governors – typically vice governors who serve as governors for an interim period without being formally appointed to this position – will not be counted in the total number of governors. Second, governors reappointed for a second or third term will be counted once. Third, due to the very specific political situation and the short history of independence of some SEE countries, a departure from earlier definitions of the reference period was necessary: While Dvorsky (2000, p.18) uses the date of enactment of the first Western-type central bank law as a starting point, this paper takes a more pragmatic approach to arrive at a reasonable duration of reference periods.

Taking into account the particular history of Bosnia and Herzegovina, Croatia, Macedonia, and Serbia, the start of operations of the – newly established – central bank is defined as the starting point of the respective reference period. For the remaining three countries, which look back on a much longer tradition of state sovereignty, the date of transformation from a monobank to a two-tier banking system was chosen as the starting point. Consequently, the length of the observation period varies between almost 14 years in the case of Romania and only 4 years in Serbia, thus reflecting the differences in recent political history.

It is interesting to note that Cukierman (1992, p. 385) defined an upper threshold for the turnover rate of 0.2 to 0.24, which corresponds to one governor every four to five years, a period that is equal to the length of the electoral cycle in most countries. Only two of the seven SEE countries examined would have met this requirement. However, in order to better understand and interpret the results found for the transition countries, the reasons for premature termination of a central bank governor's term have to be carefully questioned in every case before this step can be judged as politically motivated: Did the governor resign voluntarily for solely personal reasons (e.g. health) or was there a fundamental political disagreement with the (new) ruling party? Was the governor forced to leave, e.g. by an amendment of the central bank act, or was he dismissed?

Looking at computed results in the SEE countries, Romania records by far the lowest turnover rate, with Mugur Isărescu having been reappointed a second time in September 2004. He is meanwhile serving the longest term among central bank governors in Central and Eastern Europe. However, a closer look reveals that Mugur Isărescu left his position for more than one year in 2000 to become the country's Prime Minister. Although Isărescu formally remained central bank governor during this episode, he had handed over his duties to an interim governor. If interim governors were included in the counting, the calculated turnover rate for Romania would have tripled. Bosnia and Herzegovina, where Peter Nicholl has served an uninterrupted term since the establishment of the central bank in 1997, shows a score similar to that of Romania, the higher result being due only to the much shorter observation period. However, Peter Nicholl's legislated term of six years would have expired in July 2003 and, as a citizen of New Zealand, he would not have been eligible for reappointment, because the constitution required a Bosnian for this position. So parliament granted citizenship to Peter Nicholl to keep him on the job somewhat longer.[37] This is a most interesting example for actual CBI being even higher than legal CBI, due to the personality of the central bank governor. Comparing computed turnover rates, Bulgaria, Croatia and Macedonia record rather similar numerical results. In Bulgaria, after the – voluntary – resignation of Todor Valchev, Lyubomir Filipov served a relatively short term until the introduction of the currency board system, which entailed a restructuring of the central bank's internal organization, including the replacement of the governor.[38] Although

[37] *Nicholl announced that he would step down at the end of 2004 and be replaced by his deputy, Kemal Kozaric (see Dow Jones International News, October 4, 2004).*

[38] *In addition, Filipov had come under political pressure, as an audit report on the central bank's budget had revealed some criminal irregularities (see BBC Monitoring Service, June 12, 1997).*

his successor, Svetoslav Gavriiski, applied for reappointment after his first six-year term, he was replaced by Ivan Iskrov in October 2003, who had been proposed by the ruling political party. Croatia's first central bank governor, Ante Cicin-Sain, was replaced after somewhat more than one year, after he had come under political pressure for opposing the government's efforts to obtain direct central bank credit (see section 4.3). His successor, Pero Jurkovic, had to resign for health reasons, while Marko Skreb was called on by parliament to step down in the wake of the collapse of several of the country's banks. In Macedonia, the premature termination of the first governor's term was connected with a financial scandal: Borko Stanoevski was believed to be one of the major culprits of the pyramid saving scheme scandal in 1997 and was forced to withdraw after the Social Democrats decided that the report on the scandal could be discussed only together with his resignation (see BBC Monitoring Service, May 26, 1997). Since then, however, the situation of CBI in Macedonia has improved substantially: Stanoevski's successor as central bank governor, Ljube Trpeski, served a full seven-year term and would have been eligible for reappointment, but had little chance to be elected, because he reportedly was out of favor with the ruling coalition (see South East Europe Newswire, May 21, 2004). Albania's calculated turnover rate is substantially higher, which can be mainly explained by the political turmoils in 1997: The first central bank governor, Ilir Hoti, had to resign after a financial scandal. Dylber Vrioni left the central bank to become finance minister in December 1994 and was replaced by Kristaq Luniku. The "roughest" year in Albania's recent history of central banking was 1997, which saw three different central bank governors: In April, the political riots in Albania compelled Kristaq Luniku to leave for the U.S.A.[39] Quamil Thusha replaced him for several months and had to resign in August, following the collapse of the Berisha regime. In the subsequent years, however, the situation in Albania improved considerably: Central bank governor Shkëlquim Cani served an uninterrupted seven-year term. After the expiration of his mandate in August 2004, he reportedly submitted candidacy for a second term but was replaced by Ardian Fullani (see South East Europe Newswire, October 30, 2004). Serbia records by far the highest turnover rate of governors, which is largely due to the very short observation period. However, Mladan Dinkic's replacement as a central bank governor was a consequence of his dispute with the parliament on the adoption of a new central bank law (see section 4.1). His successor, Kori Udovicki, was replaced after only a few months, due to irregularities in her appointment (see Agence France Press, February 25, 2004).

4.3 Financial Independence in Practice

While direct central bank credit is prohibited by law in five of the seven SEE countries and only permitted under certain conditions in the other two countries analyzed (see table 3), it is worth taking a closer look at the implementation of these legal provisions in practice. Earlier work on the CEEC-5 countries provided evidence that in the early years of transition central bank

[39] *Reportedly, Kristaq Luniku accused former state leaders of interference in the affairs of the central bank (see BBC Monitoring Service, September 3, 1997).*

laws were overruled by budget laws in some cases, e.g. in Poland and Hungary (see Radzyner and Riesinger, 1997, p. 82).

In the SEE countries, evidence on fiscal financing by the central bank in practice could be found for Albania, Bulgaria, Croatia and Serbia. In Albania, parliament made use of the legislated possibility for direct central bank credit (see, e.g., Albanian Telegraphic Agency, September 25, 2004). Similarly, Bulgaria made use of the – at that time legally permitted – possibility to extend central bank credit to the government in the early years of transition. While Bulgarian central bank legislation had defined an upper limit for direct central bank loans of 5% of the revenue target set in each year, this limit was exceeded by overruling the central bank law in 1993 (see Reuters, December 2, 1993). In 1996, the situation escalated, after the general government deficit had increased to over 10% of GDP within one year. The largest part of the budget deficit was covered by an emergency credit extended by the central bank in December 1996 (see Barisitz, 2001, p. 93). The Serbian budget deficit of 2002 was partly financed by credits from the central bank, which was no breach of the applicable legislation, either (see Reuters, December 2, 2001). In 1992, the Croatian central bank governor came under strong government pressure, because the government had demanded a loan with a maturity of ten years and an interest rate below that of the inflation rate (see Vreme News Digest Agency No. 26, March 23, 1992).[40] Although Romanian legislation in force until June 2004 allowed for direct central bank credit with a maximum amount of 7% of the government's budget deficit in any given year, this provision was never applied (see South East Europe Newswire, June 9, 2004).

To sum it up, some SEE governments financed part of their budget deficits from direct central bank loans in the past. In most cases, the governments made use of a legally permitted possibility.

5 Conclusions

Reviewing central bank legislation in SEE countries, one can conclude that the central bank laws already comply with Treaty requirements in some areas, while a considerable number of weaknesses remain. This judgment is also reflected in the European Commission's institutionalized assessment.

In the field of functional independence, legislated primary objectives are largely in line with Treaty requirements in Croatia, Macedonia and Romania, while adaptations to the other laws will be needed. As regards institutional independence, all seven SEE central bank laws stipulate freedom from instructions. While most of the central banks are provided with the formal responsibility to design and implement monetary policy, the Macedonian and the Serbian legislation prescribes ex ante coordination of monetary policy with the government, which may jeopardize CBI. In the area of personal independence, the legislated length of terms is compatible with Treaty requirements in all seven countries examined. The main weakness, however, can be found in the provisions on the reasons for dismissal of central bank top officials. As to financial independence, all seven central bank laws provide that the central bank's budget is managed by the bank independently from any government institution. Furthermore,

[40] *No information was available on whether this central bank loan was ever extended.*

direct central bank credit is prohibited in five of the seven SEE countries. Major adjustments are necessary in Albania and Serbia, where direct central bank credit is still permitted under certain conditions. Moreover, adaptations will be required for provisions on loss coverage, an issue which is closely linked to the prohibition of direct central bank credit for a number of countries (Albania, Bulgaria, Croatia, Macedonia and Serbia). In addition, adjustments will be needed in the field of prohibition of privileged access to financial institutions.

As regards actual CBI, the paper shows that although the legal status of the SEE central banks is comparatively well protected, the banks are not free from political interference in practice. A closer look at the history of actual appointments and terminations of office of central bank governors confirms this impression. However, examining cases of budgetary financing by the central bank in practice, it turns out that in most cases, the governments merely made use of legally permitted possibilities.

With a view to future EU accession, a further strengthening of both legal and actual CBI will be necessary for these countries to fulfill the requirements of the Maastricht Treaty.

Cutoff date: October 31, 2004.

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