



OESTERREICHISCHE NATIONALBANK

Stability and Security.

WORKSHOPS

Proceedings of OeNB Workshops

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

October 21, 2005



No. 7

Legal Independence of the Narodna Banka na Republika Makedonija

Toni Stojanovski

Narodna Banka na Republika Makedonija

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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