THE AUTONOMY OF SLOVAKIA'S CENTRAL BANK – THE MAIN CHALLENGES

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Introduction

This decade is already proving to be the beginning of a new historical era in Europe. Western policy-makers are taking important steps towards extending the boundary of the European Union to the east. Central Europe's policy-makers are also in favour of a larger political and economic Europe. Moreover, the challenges ahead for all of us are compelling Central Europe's political leaders to improve domestic economic conditions to be ready for the increased competition of an enlarged Europe. In addition, they have to provide citizens with a basis for a better standard of living and levels of prosperity, thereby ensuring meaningful membership status.

Recent economic developments are consistent with an upswing economic recovery.

A pillar of a country's policy-making is the national central bank. A national central bank represents the major authority responsible for guaranteeing a stable macroeconomic environment and combined with a solid financial system promotes a competitive environment, both at home and in the European market place.

Links are being forged between European players in terms of higher volumes of import and export, closer ties between political institutions and the efforts of policy-makers to implement membership policies. For the above reasons we decided to consider the legislation on the National Bank of Slovakia (NBS). We will compare the NBS and its independence by referring to the economic literature of the eighties and nineties. This paper contributes to the literature in two ways: firstly, virtually all scholars interested in this field of economic research made use of research tools developed over the last two decades in pursuit of an independent monetary policy. Secondly, this interest stems from the role of the NBS, which becomes 'impressive' in the light of the Euro-zone, to which we shall return later in the article.

We shall split our analysis into two parts, though strongly interconnected. In the first part, we review the literature on independence of the central bank from government. We then apply Sergi's (2000) index of independence – introduced in the first part of this article – to legislation on the NBS. The third part sums up our conclusions and gives our view of probable future challenges and the implication of the 'independence' in the management of monetary policy.

Review of the literature

It should be noted that the literature we refer to originated in the eighties and nineties. At that time, the European central bank system was not yet in operation – apart from the rules that had been 'imposed' by the European monetary system. For that period, selected questions of the two indices that the literature makes use of to measure independence may appear meaningless for the countries that are now part of the same Euro-zone.

The literature starts with Bade and Parkin (1982). This work was followed by Grilli, Masciandaro and Tabellini (1991), Cukierman (1992), Sergi (1994, 2000), being among the most significant. Table 1 shows a partial review of the literature.

The strategy of the above researchers involved adopting some 'questions' (see, for example, table 2, left-hand column) to get some idea of their compliance with the respective national bank acts. Since Bade and Parkin (1982), two different aspects of independence have been identified. Bade and Parkin (1982) named them "financial" independence and "political independence". In Bade and Parkin's (1982) first index were included indicators of

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[3] B. S. Sergi (2000). A New Index of Independence of 12 European National Central Banks: The 1980s and Early 1990s. Journal of Transnational Management Development, Vol. 5(2), pp. 41-57.

[4] R. Bade and M. J. Parkin (1982). Central Bank Laws and Monetary Policy. Mimeo, University of Western Ontario

[5] V. Grilli, D. Masciandaro and G. Tabellini (1991). Political and Monetary Institutions and Public Financial Policies in the Industrial Countries. Economic Policy, N. 13, pp. 341-392.

[6] A. Cukierman (1992). Central Bank Strategy, Credibility, and Independence: Theory and Evidence. Cambridge, USA: The MIT Press.

[7] B. S. Sergi (1994). On the Statutory Autonomy of the Czech National Bank. Eastern European Economics, Vol. 32(5), pp. 23-35.

Table 1 Review of the methodology applied

	Type of weight	Weight	Author(s)	Extension	Countries
I.	Fixed-weight	0 – 1	Bade & Parkin, 1982		12 OECD
		0 – 1		GMT, 1991	18 OECD
		0 – 1		Sergi, 1994	Czech Rep.
II.	Scaled-weight	0 – 0.33 – 0.66 – 1	Cukierman, 1992		70 (various)
III.	Varying-weight	0 – 1; 0 – 2; 0 – 3	Sergi, 2000		12 (EU)

independence like the government's power to set the salary level for the central bank's executive body, to control the budget of the central bank and to allocate its profits. The second index included indicators of political independence like the power to appoint the Board members, the participation of a government representative on the Board and the role of government in the conduct of monetary policy.

Each indicator of independence receives a weight ranging from one to zero in the fixed-weight approach, where one stands for an affirmative answer and zero a negative answer. That is, in the fixed-weight approach, either one or zero prevails permanently. To derive the degree of central bank independence the simple procedure of adding them together was adopted. A high value indicates a high level of independence. This is the fixed-weight approach used in earlier papers.

Table 2 Indices of central bank independence and the varying-weight indicators of independence

	Political index	Weight
	Indicators of political independence:	
1	Governor not appointed by government	1
2	Governor appointed for more than 5 years	2
3	Executive body not appointed by government	1
4	Executive body appointed for more that 5 years	2
5	Explicit conflicts between the central bank and government are possible	1
6	No mandatory participation of government representative in the executive body	2
7	No government approval of monetary policy is required	2
8	Statutory requirements prescribing that the central bank must pursue monetary stability	3
	Ekonomic index	
	Indicators of economic independence:	
1	Direct credit facilities are not automatic	2
2	Direct credit facilities are at market interest rate	1
3	Direct credit facilities are temporary	3
4	Direct credit facilities are of limited amount	2
5	The central bank does not participate in the primary market for public debt	3
6	The discount rate is set by the executive body	3
7	The exchange rate parities are set by the executive body	3

Source: Sergi (2000).

Nevertheless, in the first approach that was typical in the early literature, no allowance was made for the important fact that the selected questions (indicators of independence) might be different in terms of importance and impact on the management of monetary policy. While Cukierman (1992) partially allowed for such a possibility by introducing a new scale of one-zero where 0.33 and 0.66 are equally possible according to the answer given, Sergi (2000) adopted a varying weight.

Let us clarify the new approach: Cukierman found that the fixed-weight used in the literature needed improving, especially when comparing countries with different economic structures. Cukierman simply adopted the scaling method (i.e., 0-.33-.66-1), Sergi (2000) argued "that such a scaling choice should apply not within the individual questions, but between the questions. The strategy of using different weights (i.e., we diverge from the common rule "zero-one") might seem more likely to succeed." (p. 48). His index, "proves appropriate in a broader analytical context of comparing economies at different stages of development and in transition economies as well" (p. 48).

In this article, we follow Sergi's (2000) varying weight and in tables 2 and 3 his two political and economic indices are given, as well as the ranking of twelve European national central Banks.

The political and economic independence of the NBS

Following the previous analysis, we now determine the compliance of the NBS's statute with the political and economic indices (see table 4).

Table 3 – The political and economic independence of 12 European national central banks

	Political index	Economic index	Overall index
Austria	6	11	17
Belgium	2	9	11
Denmark	6	7	13
France	4	8	12
Germany	12	14	26
Greece	2	5	7
Holland	10	11	21
Ireland	7	9	16
Italy	6	5	11
Portugal	2	5	7
Spain	4	5	9
UK	2	11	13

Source: Sergi (2000).

Table 4 – The compliance of the NBS's statute with the political and economic indices

	Political index					
	Indicators of political independence:	**True/ False**	**According to the article***	**True = 1 False = 0**	**Weight**	**Value of indicator**
1	Governor not appointed by government	F	§ 7/2	0	1	0
2	Governor appointed for more than 5 years	F[8]	§ 7/4,5	0	2	0
3	Executive body not appointed by government	F	§ 7/3	0	1	0
4	Executive body appointed for more than 5 years	F	§ 7/4	0	2	0
5	Explicit conflicts between the central and government are possible	T	§ 7/10 + § 1/1, § 12/2, 3 + § 13	1	1	1
6	No mandatory participation of government representative in the executive body	T	§ 8/4	1	2	2
7	No government approval of monetary policy is required	T	§§ 3, 4, 12	1	2	2
8	Statutory requirements prescribing that central bank pursues monetary stability	T	§ 2	1	3	3
				Overall political index (max 14)		**8**
	Economic index					
	Indicators of economic independence:	**True/ False**	**According to the article***	**True = 1 False = 0**	**Weight**	**Value of indicator**
1	Direct credit facilities are not automatic	T	§ 25/1	1	2	2
2	Direct credit facilities are at market interest rate	T	–	1	1	1
3	Direct credit facilities are temporary	T	–	1	3	3
4	Direct credit facilities are of limited amount	T	–	1	2	2
5	The central bank does not participate in the primary market for public debt	F	§ 23/b + § 26 + § 27/1,2 + § 31	0	3	0
6	The discount rate is set by the executive body	T	§§ 18, 20	1	3	3
7	The exchange rate are set by the executive body	T	§ 28/a	1	3	3
				Overall economic index (max 17)		**14**
				Overall index (max 31)		**22**

Notes:
*According to the article marked in the above column, on the Act on NBS No 566/1992 adopted by the National Council of Slovak Republic in May 1, 2001

POLITICAL INDEX

1) Governor not appointed by government

The Governor of the NBS is designated by the president of the Slovak Republic. The president acts on the proposal of the government, which must be approved by Parliament (National Council of Slovak Republic – hereinafter NB SR). The designated Governor becomes an employee of the NBS.

2) Governor appointed for more than 5 years

The period of office of the Governor is set by law at exactly 5 years. However, membership of the executive body of the NBS may extend over two such periods of office.

3) Executive body not appointed by government

The executive body numbers eight members: the Governor, two vice-governors, two CEOs (NBS's directors) and three other members. The two CEOs – members of the NBS's executive body – are appointed and recalled by the government at the Governors instigation.

4) Executive body appointed for more than 5 years

The executive body is appointed for the same period of office as that granted to the Governor. The executive body may act during a period of office lasting exactly 5 years. The same possibility as that applied to the Governor – to act during two periods of office – is granted to the executive body as well.

5) Explicit conflict between the central bank and government is possible

Conflict between government and the NBS is possible.

[8] Article 49a paragraph 2 of The National Bank of Slovakia Act amended by Act No. 149/2001 states: "The term of office of a Bank Board member is governed by regulations applicable at the time of his/her appointment." The present governor was appointed before the latest amendment took effect. His period of office is therefore six years – as was stated in the Act at the time of his appointment.

Though no mention of this matter could be found in the law, there are several signs that could support our opinion. Here are some of them:

First, conflict could arise during the process of recalling members of the executive body. If this kind of conflict arose, it could be solved neither by a government directive nor by an NBS executive body decision. This conflict could be solved only by an independent body, i.e. the courts.

Second, according to another statement, the NBS in pursuing its main aims acts independently. Before the last amendment of the Act on the NBS was passed in May 2001, an important discussion on the independence of the NBS took place[9]. The independence of the NBS became literally guaranteed with the last amendment of the Act on the NBS. For the first time the independence of the central bank was guaranteed – this is mentioned at the beginning of the Act on NBS (§1/1). Accordingly, the NBS is not obliged to follow any directive of an external body.

Third, the conclusions and decisions adopted by the NBS's executive body are merely the subject of information to the government. In contrast, the NBS adopts only a viewpoint regarding suggestions that are intended to be discussed at government meetings.

Fourth, the NBS is in the position of governmental advisor in the area of its competence.

Finally, the Governor, or one of the two vice-Governors, is permitted to participate in the government's meetings on an observer only basis.

6) No mandatory participation of government representative in the executive body

The executive body's meetings are not open to the public. The government representative has the possibility to participate.

7) No government approval of monetary policy is required

It is not the job of the government to legislate on monetary policy issues, and therefore, NBS does not require any form of governmental approval. The NBS submits to the National Council of Slovak Republic a semi-annual statement on monetary evolution (every three months after the end of the calendar half – year) and an annual statement on monetary evolution (every five months after the end of the calendar year). The NBS is to publish information (mandatory) on monetary evolution at least once every three months. The NBS publishes information on the adopted changes in the conduct of monetary policy.

8) Statutory requirements that central bank pursues monetary stability

The NBS's main aim is to maintain price stability. Consequently, the NBS adopts monetary policy, issues banknotes and coins, monitors money flow and payments and carries out banking supervision and other activities.

ECONOMIC INDEX

1) – 4) Direct credit facilities

The NBS keeps the state budget account of the government of the Slovak Republic, the account for state financial assets and liabilities, and the accounts of state funds. The NBS makes payments from state budget accounts within the amount of the remaining credit balance. The interest rate level that is set for the state budget account is settled by written agreement between the NBS and the Ministry of Finance of Slovak Republic. It should be mentioned that because of pressure from the European Commission, no direct credit facilities may be granted by the NBS to government. Former article 19, which made the granting of such facilities possible was ommited from the Act on the NBS in accordance with Chapter 11 (Economic and Monetary Union) of the Acquis Communautaire. Direct credit facilities had been used several times during 1998 and 1999. As no credit facilities are possible, discussions on interest rate, time and amount are no longer required.

5) The central bank does not participate in the primary market for public debt

However, the NBS buys and sells state bonds from/to other banks and in this way participates in the primary market for public debt. If agreement between Ministry of Finance of Slovak Republic and the NBS is reached, the NBS may act as the state bonds' manager. For performing these activities the NBS is paid – a charge on the state. In order to manage the securities' exchange rate, the NBS, for issuers account, has the right to carry on other bank trades with legal entities, and to perform services including operations on the capital market. The NBS can buy or sell guaranteed state bonds or other securities, and hold them as an asset, but for no longer than one year. The NBS, too, keeps account of short-term securities; that is, with a maturity no longer that one year, which are issued by the Ministry of Finance or the NBS and which are used for financing the state budget deficit or for managing the money market.

6) The discount rate is set by the executive body

The NBS may request commercial banks to place obligatory minimal reserves on account with the NBS. The discount rate is set by the NBS.

7) The exchange rate is set by the executive body

The NBS sets and announces the exchange rate between the Slovak koruna and foreign currencies.

Conclusion

We found that, concerning political independence, the basic legal act serves both sides – government and the NBS – with the real opportunity to be well and fully in-

[9] See the interview given by the Governor of the National Bank of Slovakia Mr. M. Jusko in 2000, 'Applying a stabilization monetary policy', Biatec 8/2000, pp. 30-32.

formed about the partner's activities, intentions and to communicate with each other. Government and NBS are to act as equal partners. We consider it important, that no one side has the right to exceed its remit, to make decisions and to grant any measures which are within the competency of the other side. We may conclude, that the NBS is politically independent.

Conclusion on economic independence. With regard to the issue of inflation and its possible connection with central bank independence, we would point out two potential threats which could jeopardise monetary stability: direct credit facilities and the primary capital market.

As direct credit facilities are not allowed, the potential threat to monetary stability no longer needs to be considered.

Although the NBS can participate on the primary market when issuing state bonds or short-term securities, the NBS acts only as a manager. Thus, the probability of the state budget deficit being financed by issuing new money is low. Risk of inflation generated by unbounded money growth due to necessity to refinance the state budget deficit is therefore also low. We may conclude, that the NBS is economically independent as well.

When comparing the NBS's overall independence index (22) with the results given in the table 3, it is possible to state that the level of independence of the NBS is close to the level of independence of the central bank of Germany.

Remarks ahead of the Euro-zone

Recent decades have witnessed, on the one hand, the collapse of the communist regimes in the countries of the former Soviet system, and on the other, the policy of the European Union – subsequent to the Maastricht treaty – is to allow membership of the countries of central Europe. Subsequent trade and foreign investment has led to significant 'reduction' in the 'distance' between the West and East sides of Europe. Nevertheless, there is still a long way to go to complete convergence.

Until quite recently, the candidate countries were taking steps towards membership[10], and a considerable part of a successful membership application rests upon a more balanced monetary framework in the East. We can now summarise the results of the previous section by underlining a few points:

1) The 'autonomy' will help to prepare the country for possible accession to the European 'arena'. By the end of 2003 – the landmark year of this new decade – final decisions will be taken and it is not a remote possibility that this country will get into the first 'wave' of accession. As a matter of fact, it would be meaningless to exclude the Slovak Republic alone[11] (the Eurocrats may decide to exclude Bulgaria and Romania from the first 'round').

2) As soon as membership becomes feasible, further acceleration of the accession process would, in principle, be advisable, though the decision whether to become a full member of the Euro-zone would depend on many factors, e.g. with the Balassa-Samulson effect on one-hand, and the possibility of eliminating the interest rate premium and thereby producing lower real interest rates on the other. This policy calls for action, such as reduced government spending and speeding - up structural change, for they have an impact on the aggregate exchange rate as indicated in the economic literature. In the end, the main aim has to become the overall stability and strength of the financial system versus simple inflation targeting.

3) Because the accession of candidate countries could probably materialise quite soon (though perhaps not enbloc), closer co-operation between candidates countries' monetary authorities is advisable.

4) Should the waiting time for European-membership take longer (i.e., 4 – 5 years), stronger integration between the European markets and increasing trading ties should make inflation more convergent with the European level – although diverging productivity rates may counterbalance such a convergence[12]. Note that in the lower-income EU countries, the Balassa-Samulson effect would cause additional inflation in the range of 1%-2%. Such a situation reinforces our argument in favour of an NBS more committed to the broader aim of overall stability of the system than to a simple antinflationary strategy.

The Slovak national bank is faced with an extraordinary decade ahead. The Bank should rely on its own expertise and total independence from the government, in order to guarantee the country the needed stability and financial strength.

[10] On the Slovak economy's development see the thoughtful paper by Elena Kohútiková (2002) 'Slovakia on the Road to a Market Economy', in G. Tumpel-Gugerell,L. Wolfe and P. Mooslechner, Completing Transition: The Main Challenges (pp.51-59). Berlin, Heidelberg and New York: Springer-Verlag.

[11] In this respect, see also Paul J.J. Welfens (2001). Stabilizing and Integrating the Balkans: Economic Analysis of the Stability Pact, EU Reforms and International Organizations. Berlin, Heidelberg and New York: Springer-Verlag.

[12] According to recent estimates there will be a fluctuation band for the real exchange rate with respect to the productivity differential, of about one half.