

THE CENTRAL BANK'S RELATIONSHIP WITH THE STATE

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Abstract: *This article analyzes new trends of the Central Bank's relationships with the State in the present context of sharp acceleration of the Central Bank Europeanization and in a different manner than classical analysis of the NCB independence and policy instruments. The paper proposes an alternative view through the lenses of two Central Bank functions (international relations function and public utility function) to identify better not only why and how (the mechanism) but also under which conditions (the scope) these two functions may work as a system of governance that slowly synchronizes with the whole Central Bank governance model. Is this approach a viable response to new challenges, paradigm shifts, uncertainties and dilemmas of the early 21st century? This paper suggests that a Central Bank can better face the 21st century economic and financial challenges only if it encourages innovation of its governance model, its specific functions and its policy instruments.*

Keywords: nation-State, European State still in formation process, Europeanization, Central Bank, governance model

JEL Classification: E58, K0, Z18

1. Introduction – the necessary delimitations

At first glance, while the literature has already contributed much to illuminate the Central Bank's relationship with the State from the perspective of independence, transmission mechanism efficiency, or use of specific policy instruments, theorizing both concepts from this article's title

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confronts two institutional entities with different background and scopes: while the nation-State, seen in the Westafalian sense, has a venerable history and origins, the history of NCBs goes back only to the 17th century (Ferguson, 2013), when they were chartered to lend the government funds, or to act as a clearing house for commerce, or to stabilize the currency after episodes of hyperinflation and then to aid in government finance. And then, why more interest in this topic and why an *otherwise* analysis?

The 20th century has changed, for good, the Central Bank institutional credibility, setting up the balance of power between the Central Bank and the nation-State. Deepening reform of the Economic and Monetary Union (EMU), which began with the 21st century, creates pre-requisites for emerging the European State, still in formation process. How do the Central Banks react to these challenges? The purpose of this article is to unpack five milestones that confer uniqueness to the EMU reform, and to assess their impact on the Central Bank's governance model from the perspective of two functions: (i) the international relations function, which in pre-accession stage initiated the process of Central Bank Europeanization through imitation and innovation, and after accession has fostered the concept of "European Component of the Central Bank" implementation as a system of governance; (ii) public utility function, which has opened up new avenues for understanding the institutional efficiency through the lenses of improving public perception about NCBs policies and messages. To meet this goal, some delimitations are required:

a) *Conceptual delimitation* is required to broaden the scope of analysis of the Central Bank's relationship with the State, from the national level to the European level. The European State is defined here as a part of solution for the ongoing European Union (EU) reform able to merge all Member States (MSs) within a political more-integrated economic and monetary, fiscal, and financial unification. The concept of a nation-State and the concept of a European State, still in formation process, have here a symbiotic interaction, a fusion created to aid in understanding the EU reform: the first concept is used in the sense of Westphalian system, the foundation of the modern system of sovereign nation-State, while the second concept is defined in the sense of Haas¹ (1968, p.16), based on the

¹ A process whereby political actors in several district national settings are persuaded to shift their loyalties, expectations and political activities toward a new center, whose institutions possess or demand jurisdictions over pre-existing national states. The end result of a process of political integration is a new political community, superimposed over pre-existing ones"

theory of European integration. The representativeness of the European State, still in formation process, is charged for this article in terms of power of European institutions to reform and complete the EU project, but should not be overstated as a substitute for national reforms. Also, this article distinguishes between the theory of European integration, which explains the process of integration itself (Radaelli, 2003, p.33) and Europeanization, defined broadly by Olsen (2002, p.923-924) through five aspects “involving changes of external boundaries, the development of political institutions at the EU level, central penetration of national systems of governance, exporting forms of political organizations and a political unification process” (Fink-Hafner, p.808). Given this context, aspects of the NCBs Europeanization are addressed more rather from an institutional perspective than a joint cultural, economic and social perspective, without however ruling out a few items of political type-Europeanization.

b) Institutional delimitation is required to enhance the overall coherence of this paper. The dominant concept is the National Central Bank member of the European System of the Central Banks (short NCBs) identified by the literature with a governance model of a conservative central bank (Rogoff-type central bank or Rogoff model), characterized by: a sole primary objective- price stability; principles of operational, financial, personal and institutional independence; tasks and functions guaranteed by the Treaty on the Functioning of the European Union (TFEU) and secondary legislation; the European Central Bank (ECB) and the German Central Bank (Bundesbank) are used as institutional sources of reference.

c) Temporal delimitation is required to confer the analysis a meaningful place in time and space. It is an obvious fact that a NCB today is largely different from those of 100 years ago. Understanding perceptions of reality of other times can offer a causal explanation of its course, although the study of history is not a toolkit with instructions that can be instantly available; history teaches us through analogies (Kissinger, 2010, p. 24). This article limits its analysis at the evolution of central banking in Europe during the 20th century and early 21st century, with a focus on the current reform of the EMU, rather intending to generate a dynamic overview, than pretending to write a historical chronicle.

d) Functional delimitation is required to advocate a causal connection between the NCB international relations function and the NCB decision-making process, based on the reality that the NCB Europeanization, initiated in the accession stage, has fostered, after accession, the implementation of

the “European Component of the Central Bank” concept as a system of governance that slowly synchronizes with the whole NCB governance model. This article outlines only the first and the second categories of what Goetz (2001, p. 212) “distinguished in the debate on executive Europeanization as three broad categories concerned with linkage, implementation and executive ecology” (Fink-Hafner, 2007, p. 808).

The paper proceeds as follows: first chapter describes timeline evolution of institutional development of the NCB's relationship with the State, investigating the causal relationship between imitation and innovation underneath the NCB Europeanization. The next section advocates for reconsidering the priority of the international relations function in the process of synchronization of a NCB with the nation-State and the European State still in formation process. European Component of the Central Bank is associated here with the last stage of the Europeanization process implementation, seen as an end-institutional product that goes far beyond harmonization and transposition by merging national and supranational governance models; The last chapter discusses institutional effectiveness, using the NCB public utility function as a solution for solving the mismatch between the need to improve public perception and the reluctance to allow a higher degree of transparency about NCB decisions.

2. Institutional framework of the Central Bank's relationship with the State

2.1. Historical evolution

The first part of the 20th century provided many examples of the NCBs autonomy of the fiscal authority (the time between the two world wars and post-war). Afterwards, there was a rebound, by converting NCBs in institutions insulated from political involvement. Why this change and what was happening between these periods of time?

- *during the 1930s-40s* the State gained its greatest power, strengthening the role of the Government as a result of mixture of factors such as: Keynesian economics, which arose in the 1930s in response to the Great Depression, the socialist ideology, the corporate culture and consumerism. For NCBs, the influence of government policies -roughly sketched by the idea that who has the political power automatically imposes the Central Bank policies (Singleton, 2011, p. 286) -, was exercised in the

sense of overregulating, and thus exerting control over monetary policies, exchange rates, and the banking system.

- *the last four decades of the 20th century* outlined conditions for undertaking a substantial public sector reform mobilized by a disgraceful failure of the Keynesian economic policies, and public perception about politicians inability to deal with the aggravation of consequences generated by "this drug called inflation" (Isarescu, 2001), translated in reality not only by double digit inflation, but also by double digit unemployment, double digit interest rates, all at the same time, along with four successive worsening recessions from 1969 to 1982. Cutting off the link between monetary policies and governmental policies called for a new architecture of the central bank orthodox framework defined by: (i) NCBs independence, (ii) sole primary objective—maintaining price stability, and (iii) inflation targeting regime (Singleton, 2009, 2011, p. 278). And thus, by the end of the 20th century, NCBs gained such a "position of power and responsibility in their unrivalled history" (King, 1999, p. 11) that led researchers to project a bright future of central banking, even assuming the risk of generalization, although the "generalization seems to be the greatest danger of the 21st century" (Michnik, 2011). The global picture of the NCBs evolution within the last decades of the 20th century was backed by an extraordinary institutional credibility acquired in the process of the public sector reform; however, the more influential NCBs became at the national level, the more pressures were added in the relationship with the nation-State authorities, so that, the only solution agreed by all stakeholders was a positive trade-off between accepting the NCB independence principles and their transposition in the NCB national legislation; it eventually happened throughout the EU, with the signing of the Treaty of Maastricht, under the name "the EMU *acquis communautaire*", as mandatory accession criteria.

- *the 20th century seemed to be ending triumphantly*: in Europe, the NCBs broke through the influence of politics irrevocably, acquiring full independence from State authorities, inflation -the nightmare of Germany- was firmly under control, inflation targeting regime operated effectively, the NCBs credibility was at its climax, the central bankers reputations was higher than ever. Across the ocean, in the U.S., the situation was also flourishing: (i) there was an explosion of the mortgage loans by the "American dream" program, implemented as a result of applying a long-term relaxation in lending policy and eliminating restrictions of the Glass-

Steagall Act, (ii) the "financial accelerator" (Bernanke, 2007, p. 1) operated at peak levels, and (iii) economic and social environment conducive to financial, technological innovations boosted investors' appetite for risk. Everything seemed in the canons of the orthodox monetary policy manuals. However, a few signs were meant to signal troubles: (a) excessive financialization through innovating complex instruments of financial engineering, (b) internationalization of capital and financial markets, (c) a tendency of overvaluation of asset price equilibrium value, (d) inadequate economic policy allocating deficient financial and capital resources, (e) a mix of expansive monetary policy with over-indebted fiscal policy, which encouraged mortgage lending and exacerbated their financialization in developed countries and eventually, (f) a model of consumption-oriented economic growth. All they went out to the surface first in the US, in June 2007, when serious problems become apparent at two Bear Stearns hedge funds with a high exposure to sub-prime mortgages.

- *The year of 2007* was labeled by many analysts as the end of the most goading era ("the golden age of central banking" Singleton, 2011, p. 288) in the history of central banks both on the European and the American continents, where Alan Greenspan ended up his mandate as the most successful central banker of the FED (Nelson, 2007, Khan, 2005).

- *The 2008 to present* - with the outbreak of financial crisis in the US and having it spread in Europe by the contagion effect as well as the high level of globalization of markets, capital and financial services, the European authorities have understood the need for immediate action on cooperation and coordination at European level, by broadening dialogue with all institutions, including NCBs, with a view to speeding up the process of deepening EU political unification and, enhancing the European state still in formation process. In response to the crisis the MSs, the euro area and the EU as a whole have taken a broad range of measures to improve economic governance reform; on the academic side, researchers have showed interest to reshape the limits of the Central Bank's relationship with the State, from the perspective of improving the transmission mechanism effectiveness. It seems obvious that the purpose of innovation, introduced in response to new challenges posed in terms of tools, policies, functions, operations of NCBs, is to test the ability of the present NCB governance model to accommodate the new realities, without changes in principles of independence and sole mandate.

2.2. The 20th century: Europeanization as imitation or as innovation?

The sub-title mirrors Trontal's study (2205) about the Europeanization models in the field of research and higher education policy, to better illustrate the empirical validity of the European integration impact on the NCB governance model. The main rationale of this chapter is to investigate the causal relationship between imitation and innovation underneath the NCB Europeanization. In the context of the NCB synchronization with the nation-State and the European State still in formation process, *five milestones that confer uniqueness to the EMU reform* are explored to assess their impact of the NCB governance model; the next chapter takes up this idea and discuss the concept of "European Component of the Central Bank", as an end-institutional product of the NCB Europeanization, that goes far beyond harmonization and transposition towards a merge of national and supranational governance models, especially for recent post-communist non-euro NCBs tightly coupled to their national background, which inherited specific social, cultural and geopolitical factors:

a) European integration and Europeanization:

In a Europe exhausted by two devastating world conflagration, the will to build up sustainable institutions and a long-term political vision of some prominent EU founding parents-leaders were the driving forces that powered the most important project of the 20th century started in times of peace on the European continent. The EU project is not unique in the modern history of Europe (Eichengreen, 2007). Previous projects focused more on individual goals such as the common monetary area, or on complementary goals than targeting fiscal or political unification. In 1957, the Treaty of Rome set up the legal framework for the establishment of a monetary union. It was only in 1970 when the Werner Group envisaged a plan in several stages aimed to achieve full economic and monetary union within ten years, meaning to achieve full liberalisation of capital movements, the total convertibility of MSs currencies and the irrevocable fixing of exchange rates and the adoption of a single European currency as a possible objective but not as a goal in itself; furthermore, the report recommended that the coordination of economic policies be strengthened and guidelines for national budgetary policies drawn up. Although there are two somewhat similar precedents in history- the Latin Monetary Union and

the Scandinavian Monetary Union- EMU has some peculiarities, which make the difference:

- the first strand relates to the Europeanization of national institutions and thus to the NCBs, which takes place in the context of creating a new European identity once joining the EU; this article does not discuss the link between the European integration and the European identity, but merely set the reference institutional area of the Europeanization process. Most researchers start their studies from the idea that the Europeanization means “adaptation of national structures, processes and actors and not the replacement of the ”old” national ones with something homogenous that is “European-modeled”” (Fink-Hafner, 2007, p. 805) -for details see Spanou 1998; Kassim et al. 2000; Bulmer and Burch 2001;Laffan 2001; Page 2003. In a comparative analysis of the process of Europeanization in six MSs (Ireland, Greece, Finland, Hungary, Slovenia and Estonia, Laffan (2003) concludes that the “patterns of executive adaptation vary according both to the level of institutionalization and the relationship between formal and informal process” (Fink-Hafner, 2007, p. 806). That explains our preference for Radaelli’s definition of Europeanization (2003, p. 30), seen as a process of: (i) construction, (ii) diffusion and (iii) institutionalization of formal and informal rules. “These include procedures, policy paradigms, styles, ways of doing things and shared beliefs and norms, all of which are, firstly, defined and consolidated in the EU policy process and, secondly, incorporated within the logic of domestic (national and sub-national) discourse, identities, political structures and public policies” Radaelli (2003, p. 30), (Fink-Hafner, 2007, p. 806).

- the second strand distinguishes between European integration, which “is the act of strengthening the influence and the decisional power of the European community, the sovereignty being transmitted from the national level to the European level”, and the Europeanization, which “means the change produced in the internal context of each country through enforcing in models, norms and community policies, which imply substantial modifications in the national policies and in the institutional framework of their adoption and implementation” (Schifirnet, 2011, p. 241)

- The third strand is given by the chance acquired with the EU integration by each MS to achieve the standards of the European development model by specific EU means. In the implementation stage, this chance has been treated differently: some MSs used innovation while other

MSs stayed with imitation—and here is the case of some ex-communist non-euro MSs newcomers that lost the democratic tradition of alternation in power as well as the practice and the willingness for promoting inter-institutional coordination policies.

b) The European Central Bank as a supra-state Central Bank

The NCB Europeanization and its institutional building end-product, namely the “European Component of the Central Bank” follow closely the institutional pattern of the ECB. Historically, although there are three cases of so-called common central banks in the European history of the last two centuries, their operating system cannot be compared with the ECB governance model: (i) the Austro-Hungarian Bank became the central bank of both parts of the Empire and operated from 1878 to 1919 in an institutional dualist context (two governing boards and separate head offices in Vienna and Budapest); (ii) the Sterling Area set as “a group of countries that kept most of their exchange reserves at the Bank of England and, in return, had access to the London capital and money market” (Encyclopedia Britannica); (iii) by the French agreement CFA franc – by creating it, Banque de France together with the French Treasury and 14 central banks of Western and Central African States, former colonies of France, were able to avoid devaluating currencies in its colonies (Singleton, 2011, p. 259).

c) Central Bank independence and monetary conservatism

With a history of about three and a half centuries, central banks were initially chartered to lend the government funds, or to act as a clearing house for commerce, or to stabilize the currency after episodes of hyperinflation and then to aid in government finance. The 20th century brought in a radical change of vision, especially in its last three-four decades when studies of Kydland and Prescott (1977), Calvo (1978), Barro and Gordon (1983) and Rogoff (1985) about the central bank independence were initially echoed in the academic world and only afterwards they were largely implemented in the EU. Negotiating and formalizing them as basic principles of the EMU in the Delors Report was not only the victory of a NCB governance model which has proved viable in the struggle with inflation (Bundesbank), but it paved the way for emerging of a small community of central bankers, who progressively became a technocrat elite in a financial world with more and more political and economic linkages and interests. For the first time in the

European economic and monetary history, an influential group has managed to facilitate uniform implementation of some elements of extraordinary uniqueness, which irrevocably changed the history of central banks in Europe: (i) the principles of independence and governance for a single unified Central Bank and a system of national central banks, (ii) a single mechanism and unique rules for elaborating and conducting monetary policy and its decision-making process, (iii) unique rules concerning the unified central bank day-to-day operational framework, and (iv) recommendations about EMU (budget deficit limitation and macroeconomic policy coordination).

Although hardly accepted by politicians, the NCB independence can be considered one of the greatest achievements of the European central banking in the 20th century, leading to increase its influence and credibility in the international financial world. No other principle that governed central banking in the course of its history has proved how necessary is to gain consensus between external and internal priorities, in order to allow NCB to contribute to the management of national macroeconomic policies and to optimize its relationship with national and international financial institutions. “Today most central banks are independent, headed by non-elected officials, and quite powerful. This set-up is acceptable only if independence is limited by the mandate. That’s the framework the legislators have given us [...]. That is why we are so keen about respecting the mandate, because that’s the true guarantee of our independence, which [...] is crucial for our credibility. And credibility is essential for delivering price stability”. (Draghi, 2013; Weidmann, 2013).

d) Sole Mandate - maintaining price stability

So far, in the era of central bank orthodoxy consensus, the European central banking has delivered some pragmatic notable results. Among these, the ECB and the NCBs institutional, functional, operational and financial independence is considered the most prominent achievement as it is enshrined in the Treaty of Functioning of the European Union (TFUE). After the crisis emerged, maintaining medium term price stability status quo as a similar sole primary objective for all NCBs remains of the utmost importance to understand the course of monetary policy stance and decisions. “Delivering on their mandate is the only way for central bankers to maintain public trust” (Draghi, 2013). However, NCBs in unconventional

times need to remain credible and become creative since “policy requires an understanding of theory but must be grounded in economic reality if it wants to be effective” (Isarescu, 2012). In other words, a successful NCB could continue focusing on preserving the similar link between a tightly coupled sole mandate and its independence from political control; but it could do considerably more on rebalancing the variety of functions or other institutional changes introduced in the NCB governance model in the last years, in order to improve the NCB overall effectiveness.

e) *The Central Bank's relationship with the political arena*

Seen through the lens of those four above-discussed milestones, the Central Bank's relationship with the State is built on the conviction that the political will and commitment is at the core of a constructive approach to address some of the serious challenges of the EU governance. Why that? One of the reasons is to enhance all EU decision-makers' legitimacy, meaning both political leaders -who are requested to approve the ongoing EMU economic governance reform, and technical experts -who participate directly in negotiations. Another reason underlying the viability of political involvement is that it can stand on its own feet only if a functional multiple coordination with all stakeholders is set aimed to act as a catalyst as well as a way of building consensus at both national and European levels. NCBs could only play a limitative role: they have a strong ability to influence the course of negotiations and implementation of the ongoing European projects more on a consultative side, as a technical advisor, than as a political direct-involved player.

3. The international relation function, the linkage of the Central Bank with the State

This section looks into the manner an NCB develops a synchronization relationship with both the nation-State and the European State still in formation process to avoid fragmentation of the NCB governance model; arguably, the NCB international relations function reflects the degree of Europeanization in relation with national and European authorities as well as international financial institutions. It does not call for reinventing the NCB institutional framework but emphasizes the need to bring the European affairs back on the NCB Board agenda, to prioritize it on the top of the list and to diversify the NCBs tools of

cooperation with European and international organizations, within the legal limits of the Community legislation. The better a NCB manages to convince the national authorities to approach cooperation as a public asset, based on a constructive and without rivalries cooperation, the greater the chance to achieve the objective of full integration in the EMU (Kindleberger, 1986). Historically, cooperation at the national and the European levels has proved beneficial when, due to internal constraints and/or international disruptions, decisive actions made sense to: (i) direct national initiatives towards a European consensus and, (ii) replace the logic of the national decision-making process with that of the European decision-making process (Toniolo, 2005).

3.1. The European Component of the Central Bank

The establishment of the ECB and the ESCB provided central bankers and banks with the chance to play an active role within the strongest professional communities in European financial history of the world, as well as the opportunity to acquire a collective European identity (Dyson, 2000, p. 72), defined as key feature of the future integrated European State. If in the last three decades of the 20th century central banking literature focused largely on the study of central bank independence and monetary policy instruments, the 21st century literature starts advocating for the need to adapt the NCB governance model to the new reality: the mismatch between the challenges and the capacity to deal with these growing challenges, threatening to turn into a vicious circle if the NCB is not adapting its governance model to meet the public expectations.

Continuing the debate on the causal relationship between imitation and innovation underneath the NCB Europeanization, the idea of this section is to explore the salience of Europeanization for a NCB governance model. The assessment of two stages of Europeanization process is chosen: the institutional building stage and the implementation stage. While the institutional Europeanization was becoming increasingly relevant once the NCB joined the ESCB, it was transferred and eventually transformed into a stronger new institutional setting called “the European Component of the Central Bank” that has to cover all areas of the NCB governance model to slowly synchronize with the NCB governance model as a whole. For a NCB, the European component has occurred firstly during the EU accession negotiations by Europeanizing its legislative and capacity building

framework; it was only after joining the ESCB when the European component has individually emerged covering only several areas: (i) the legislative transposition of the EU legislation in national legislation, (ii) a more effective policy-mix coordination at the national level, (iii) implementing the ECB monetary policy instruments, (iv) financial and human resources allocation, etc.; the process of synchronization continues with the next stages of the EU final integration (such as, joining the euro zone or the Banking Union projects for non-euro MSs).

The year of 2007 posed additional challenge for NCBs in terms of changing the perspective of cooperation and promoting new inter-institutional instruments of cooperation: to reconsider the role of the NCB international relations function in such a way as to enable the implementation of its European component. This means a change of perspective from a local, national view to a European overview for both experts involved in decision-making process and members of the NCBs decision-making bodies, by combining the science of fulfilling the commitments with European authorities with the art of serving (in the sense of pragmatically addressing to) the national state-interest in a European context. At least some factual items may influence the dosage between the science and the art of governing a NCB, such as: (i) a more pro-active involvement in negotiating arenas at Brussels and Frankfurt (moving from the status of policy takers to policy makers), (ii) an opening approach for developing cooperation within the ESCB framework based on bilateral or multilateral consultations with the ECB and with other NCBs for drafting common arguments or common positions on certain topics, or research studies and exchange of views on issues of common interest in the European affairs and, (iii) a focus on improving internal (inside NCB) and external (outside NCB) coordination. As long as the NCB cannot play an active role in reaching national political consensus, it however may have the ability to steer a national consensualization platform for both rapid implementation of the EU decisions and effective coordination to consistently represent the MS position on specific negotiation files.

3.2. Policy coordination through cooperation at the national and European levels

Once in the 1960s, there was a group of central banks and the central bankers that Helleiner (1994, p. 19) and Singleton (2011, p. 64) called "the

transnational epistemic community", i.e., an influential group of experts who have a great desire to communicate and to promote common principles and intellectual converged opinions, which varies over time, depending on the national state-interest and ideological trends in fashion. The most valuable result of this kind of internationalization policies was the conquest of the NCB independence, which definitely reset the NCBs relationships with the national authorities.

Today, cooperation is defined as a result of connection between the NCB policies and actions and international and geopolitical relations and may be described in concrete terms by: bilateral and multilateral cooperation agreements for granting/receiving technical assistance, exchanging information, best practices and topic-oriented consultations, etc. The most advanced form of the European level cooperation takes the form of cross-institutional coordination, allowing the NCBs to interact, ex-ante and ex-post, with national authorities and the European institutions under institutional and legal conditions of the TFEU. A policy of effective coordination involves risks and uncertainties, but also creates conditions for protection against possible shocks. Risks and uncertainties come mainly from the difficulty of keeping the balance of power between the NCB and the Government; the balance has changed several times during the 20th century (Toniolo, 1998, Stiglitz, 1998) and the circumstances of the beginning of the 21st century shows that, at least so far, the EU's construction should be based on the policy of cross-institutional ex-ante coordination. The shocks may arise in the case of some ex-communist MSs newcomers whose political and administrative system of the past 70 years lost the democratic tradition of alternating political powers, and whose tasks of coordinating administrative policies virtually did not exist until the start of EU accession negotiations. That is why one of the first reforms of the EMU governance has been towards improving ex-ante coordination at the level *of all* MSs and with other relevant European authorities (the EU, the Council, etc.), by an ex-ante coordination of the macroeconomic policies on preventive and corrective sides of the Stability and Growth Pact.

It becomes obvious that this new type of ruling by governance has gained in salience, departing from the traditional "Community method" of regulation through legislation. By promoting new measures of reforming the EMU governance based on coordination through cooperation, the EC has made clear its intention to fasten the process of political convergence. The

ultimate goal - political unification - becomes more important than any of the national state-interests of any MSs, and no MS can afford a competition of their own state-interests- sometimes short-term conflict of interests- to endanger this goal. A formal transfer of powers from national level to European level takes place (Hodson and Maher, 2001, p. 16; Eberlein and Kerwer, 2004) and, in the end, the rationale of national authorities may converge to the rationale of the European decision-making process, paving the way towards political Union.

4. Public utility function and public perception of the Central Bank

The NCBs credibility in the EU at the end of the 20th century was built on the foundation of the independence principles, when the State's intervention in the NCB affairs was minimal, with the complicity of at least three factors: (i) the Governor's (and possible other decision-makers) appetite to exercise the power of an independent institution by implementing decisions in an independent manner, minimizing the exogenous influences and the political exposure, (ii) the central bank commitment for implementing long-term consistent anti-inflationary policies, especially in countries such as Germany where the hyperinflation episodes persists in the public mentality, and (iii) the Governor's will to preserve the current NCB governance model, but to allow a certain degree of innovation inside the model, in response to the crisis that has hit Europe after 2007.

The NCBs credibility also means the ability and competence with which the NCB delivers to the public what it expects for a long-term horizon - stability and authority -, in a variety of forms: price stability and financial stability, authority in the decision-making process, policy control and the ability to make us properly and effectively by its specific instruments, seriousness in achieving other secondary objectives (Iling, 2006). As the NCB credibility seems to be directly proportional to the degree of expectation that society is prepared to tolerate, the NCB may opt either for reinventing its own mandate -which requires time-, or for innovation -which require immediate action and skills to combine the art with the science of governing a central bank.

Above all, the NCBs credibility starts with "rule of law", that transposes in the national level, with maximum fidelity, provisions of the TFEU and related secondary Community legislation. When there is a certain degree of flexibility to accept a particular type of policy cooperation with

the Government or a certain degree of transparency in the NCB policy communication, even within the current legal framework, then it may be entered in areas of risk and vulnerabilities. A new challenge is facing the central bankers in the last couple of years: publication of the minutes of monetary policy Board meetings. To this request to increase the degree of transparency in communication Tognato (2005, p117), quoting Issing (1999) and Winkler (2000), have responded with a different type of approach generically called “multi-lingual institutional language”; it proposes, in essence, a diversification and a segmentation of the NCB data and information on categories of target audiences able to absorb, in a consistent manner, a large diversity of the NCB messages (including discussions related to the decision-making process).

Starting from the idea that the NCB institutional effectiveness is a compromise, in the good sense of the word, between credibility and flexibility, we plead in favor of maintaining the NCB credibility by *improving the public perception* with respect to key messages of the NCB policies and actions and by widening the degree of transparency in its communication policy. How would it be possible?

- The first suggestion is that the policy of transparency of the NCBs decision-making process could evolve from a homogeneous category of target audience (typically, the academic elite may show a larger appetite for spelling out the Board discussions), to several clusters of target audience (“collection of audiences”), segmented according to their topics and areas of interest (Lohmann, 2003, p. 106). This explains the NCBs recent involvement in financial educational projects or in cultural projects at both national and European levels, as well as their specific interest to improve the public perception about the Central Bank policies, messages and actions.

- The second suggestion refers to the relationship, sometimes symbiotic in the collective memory, between the credibility of the institution and the reputation of the one who is leading it: some governors stood out just by their presence in a temporary function, other governors were noticed by conscientiousness and rigor with which they fulfilled the institutional tasks and duties entrusted to them, but only few governors were those who glowed through with their personality and charisma and step down in history as the *state* leaders who serve the *state* interest. Vicarelli (1988, p. 9) was the one who argued that central bank independence essentially depends on the personality of its governor so that the governor’s reputation fuels the NCB credibility and vice versa, in a continuous virtuous circle. In this case,

the NCBs, together with the Ministry of Finance and other national financial institutions, enters in the position of "primus inter pares" (first among equals) within the framework of a national network of power poles where only one out of two outcomes becomes relevant: either all efforts are channeled to construct a powerful network, capable to maintain the balance of power among all institutional poles, or they may enter into a competitive inter-institutional status, which affect the long-term national state interest. No matter the power and influence a NCB has gained at the national level, it cannot become a universal panacea or a substitute for structural reforms, for economic growth or for increasing the standard of living. A mitization of such an illusion is likely to induce unrealistic expectations and to damage the NCB credibility.

5. Conclusions

The 20th century has changed, for good, the Central Bank institutional credibility, setting up the balance of power between the Central Bank and the nation-State. Deepening reform of the Economic and Monetary Union (EMU), which began with the 21st century, creates pre-requisites for emerging the European State, still in formation process. How do the NCBs react to these challenges? The rationale of this article was to unpack five milestones that confer uniqueness to the EMU reform, and to assess their impact on the NCB's governance model from the perspective of two functions: (i) the international relations function, which in pre-accession stage initiated the process of Central Bank Europeanization through imitation and innovation, and after accession has fostered the concept of "European Component of the Central Bank" implementation as a system of governance; (ii) public utility function, which has opened up new avenues for understanding the institutional efficiency through the lenses of improving public perception about NCBs policies and messages. The final conclusion is that: a NCB can better face the 21st century economic and financial challenges only if it encourages innovation of its governance model, its specific functions and its policy instruments; widening the mandate for a dual primary objective or conferring a greater degree of transparency or less independence are alternatives that not only could trigger a declining balance of power of NCBs in relationship with the nation-State and the European State still in formation process, but could also change the public perception about NCBs.

What makes today a NCB policy decision to be effective is not ideal compliance with a rule or a European regulation, but the NCB ability to

foster an effective transfer of institutional power from the national level to the European level and vice versa and thus to adapt its governance model to the new world and to the new realities. “We already live in a different world, one in which political power can no longer be monopolized by a single holder. Instead, it is distributed along a vertical scale ranging from the municipal, to the national, to the continental, to the global. [Both] camps seem to ignore that history is a dynamic process driven by contradictions.” (Padoa-Schioppa, 2010).

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