European Research Study Group Quarterly Newsletter

E.R.S.G.-Contemporary Research for a United Europe

December 2013-February 2014 — March 2014, Volume 2, Issue 2

The Political Economy of the E.M.U.
E.R.S.G.
Contemporary Research for a United Europe

Special points of interest:

- 16 December 2013 – The EU Council has today appointed Mrs. Danièle Nouy as Chair of the Supervisory Board of the single supervisory mechanism at the ECB. Previously, the European Parliament had approved the ECB Governing Council's proposal to appoint Mrs. Nouy. Until recently, Mrs. Nouy was Secretary General of the French Prudential Supervision and Resolution Authority.

In this issue:

Conclusion on the Financial Assistance Programme for Spain

The positive assessment of steadfast programme implementation that formed the basis of the Eurogroup statement of 14 November has been maintained through the final review. Spain has pulled back from severe problems in some parts of its banking sector, thanks to its reform and policy actions, with the support of the euro area and broader European initiatives.

Spanish financial markets have further stabilised. Following the drop in sovereign bond yields, and the rise in share prices, financing conditions for large parts of the economy have improved, even if financing conditions for SMEs remain more challenging. The liquidity situation and the financing structure of the Spanish banking sector have further improved as bank deposits have been rising and Spanish banks are gradually benefiting from access to funding markets. The solvency position of banks has remained comfortable after the recapitalisation of parts of the banking sector. The process of restructuring of banks having received State aid is well underway, guided by the restructuring plans as adopted by the European Commission. Efforts to implement the agreed measures need to continue as envisaged.

Compliance with the horizontal policy requirements in the Memorandum of Understanding is complete. This contributed to a thorough overhaul of the governance, regulatory and supervisory framework of the Spanish banking sector. Continuing on this path of close monitoring, pro-active supervision, advancing reform in the broader governance of the banking sector and fostering non-bank financial intermediation will help securing these achievements and contribute to a more resilient financial sector in Spain. (ECB, 12/2013)

European Commission, ECB and IMF on the Third Review Mission to Cyprus

Cyprus's program remains on track, with the macro-fiscal outturn better than expected. Fiscal targets for 2013 have been met with considerable margin, due to both continued prudent budget execution and a less severe recession than anticipated. Output in 2013 is estimated to have contracted by about 6% in real terms, which, while significant, is almost 2 percentage points better than forecasted at the time of the last review. Private consumption contracted, although by less than expected, while tourism and professional services have proven resilient. The financial sector is also showing signs of stabilization. The economy is adjusting flexibly as prices and wages are declining, helping to cushion the full impact of the recession on jobs. Still, unemployment remains very high.

The outlook remains challenging. Output is projected to contract by 4.8% in 2014, with domestic demand weighed down by the need for an adjustment of private and public sector debt from currently high levels. A return to positive but modest growth of around 1% is expected in 2015, led by non-financial services. Nonetheless, risks to the outlook are substantial.

In the financial sector, the first challenge is dealing with the high level of non-performing loans. With the two largest banks now recapitalized and the cooperative credit sector expected to be recapitalized shortly, the authorities need to ensure that banks and cooperatives effectively implement their restructuring plans. This requires putting in place adequate arrears management frameworks and carefully monitoring progress toward reducing loans in arrears.

A second challenge is the need to normalize payment flows in the economy while safeguarding financial stability. With key milestones in the authorities' roadmap now completed, the second phase of gradual relaxations of restrictions is expected to start shortly. Finally, efforts also need to continue to strengthen implementation of banking sector regulation and supervision as well as of the anti-money laundering framework. (ECB, 02/2014)

Lifelong Learning

Special Points of Interest

- The annual growth rate of household gross disposable income increased to 1.5% in the fourth quarter of 2013 (third quarter: 1.0%,). This resulted mainly from increases in compensation of employees, while other sources of income increased as well, and these increases were only partly offset by the negative effect of increasing taxes.
- The annual growth rate of household consumption expenditure increased to 1.2% in the fourth quarter, from 1.0% in the third quarter, while that of household gross saving increased to 3.7% from 1.7%.
- The household gross saving rate was 13.1% in the fourth quarter of 2013, compared to 13.0% in the fourth quarter of 2012.
- The annual growth rate of gross fixed capital formation of households was -1.0% in the fourth quarter (third quarter 2013: -1.4%).
- The annual growth rate of household gross non-financial investment was -1.5% in the fourth quarter of 2013, compared with -1.0% in the third quarter.

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News & Recent Key Developments

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Euro Area Economic and Financial Developments

In the fourth quarter of 2013 the annual growth rate1 of household gross disposable income increased to 1.5% (third quarter: 1.0%). The annual growth rate of household consumption expenditure increased to 1.2% in the fourth quarter, compared with 1.0% in the third quarter. Reflecting these developments, the annual growth rate of household gross saving increased to 3.7% in the fourth quarter, from 1.7% in the third quarter. The household gross saving rate2 was 13.1% in the fourth quarter of 2013, compared with 13.0% in the fourth quarter of 2012.

The annual growth rate of household financing was unchanged at 0.3% from the previous quarter, and that of financial investment was unchanged at 1.6%. Household net worth3 increased at an unchanged annual rate of 0.5%.

The annual growth rate of net entrepreneurial income of non-financial corporations increased at a lower annual rate of 2.7% in the fourth quarter of 2013, after 4.5% in the previous quarter.

The annual growth rate of gross fixed capital formation of non-financial corporations increased at an annual rate of 1.5% after decreasing previously (-1.6%). The annual growth rates of financing and financial investment were broadly unchanged at 0.7% (third quarter: 0.8%) and 1.4% (third quarter: 1.3%).

Debt of households and non-financial corporations as a percentage of GDP stood at 64.4% (fourth quarter 2012: 65.6) and 103.6%, (fourth quarter 2012: 105.7) respectively.

Household financing and financial investment were unchanged from the previous quarter (at annual growth rates of 0.3% and 1.6% respectively).

Non-financial corporations' net entrepreneurial income (broadly equivalent to current profits) increased at a lower annual rate (2.7% after 4.5%), while their gross fixed capital formation increased at an annual rate of 1.5% after negative annual rates in the previous 6 quarters.

Total Euro Area Economy

Euro area net disposable income increased at an annual rate of 1.5% in the fourth quarter of 2013,compared with 1.4% in the third quarter (see Chart 1). Euro area gross fixed capital formation was unchanged on an annual basis, after decreasing in the third quarter (-1.6%, see Chart 2). Gross capital formation, which includes in addition inventories, declined in the fourthquarter on an annual basis (-1.8%, from -0.1% in the third quarter). The prolonged weakness in gross capital formation, accompanied by increased euro area savings, led to a continued growth of net lending by the euro area to the rest of the world (corresponding to an increase in the current and capital account surplus).

(ECB Quarterly Report)

Chart 1. Growth of euro area net disposable income and its allocation to sectors (annual percentage changes and percentage point contributions)

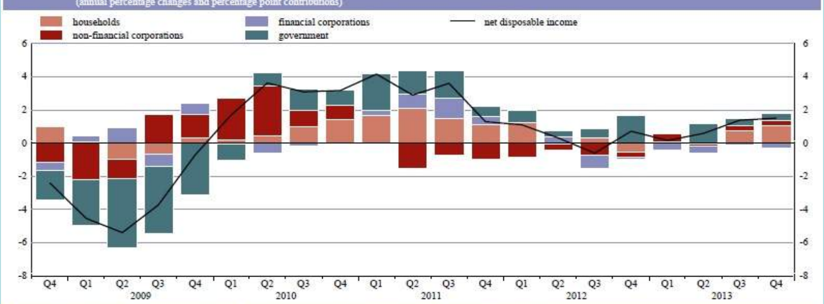
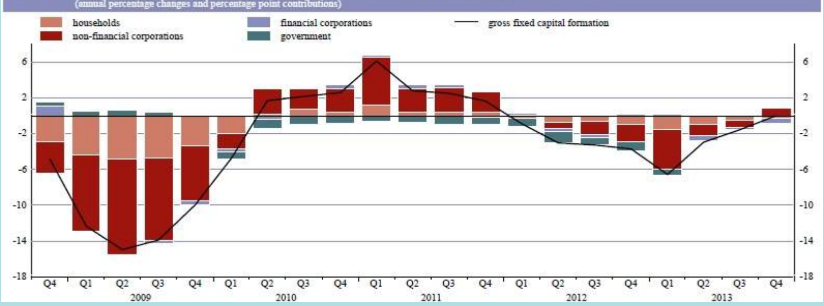


Chart 2. Growth of euro area gross fixed capital formation and contributions by sector (annual percentage changes and percentage point contributions)



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EMU and Public Sector

December 2013-February 2014

March 2014, Volume 2, Issue 2

Seeking a Sustainable Size and Structure for the Greek Public Sector's Activities According to the Fiscal Pact for the Euro—Professor Sotirios Theodoropoulos

The evolution of the modern Public Sector's size

The influence and scope of the state in the post-war period increased rapidly, mainly in the fields of providing social services and income transfers,producing goods, managing and planning the economy by fiscal and monetary instruments, investing capital and occasionally controlling the assets of financial institutions.

The economy's Internationalization suggests that nations are not wholly autonomous and entirely independent from the external world. Certain nations' 'open economies' are highly dependent on their external environment as markets for export of goods or sources of capital. Especially, a small country must go beyond its own boundaries and because of this, it is highly dependent on the behavior of foreign actors not subject to its own authority.

Continuing debates about conflicts between welfare state and competitiveness on modernization and innovation, about complementarities/substitutions of public sector can give rise to policy measures in a changing economic and social environment. Based on these characteristics, five groups of states can be distinguished in Europe as country clusters: a) the Scandinavian or Northern European, b) the Mediterranean or South European,, c) the Anglosaxon, d) the Eastern European, e) the Continental or Western European

This typology of states in Europe implies divergences in public sectors' functioning, performance, structure and size.

The Fiscal framework under the new Europact

There is wide agreement on the need for fiscal discipline in a monetary union. The importance of this pillar has been recognized since the establishment of the EMU, setting up the appropriate mechanism aiming to implement the necessary fiscal discipline.

In addition to guaranteeing the stability of the euro area as a whole and assisting individual member states in financial difficulties or serious market pressures, the following temporary financial backstop mechanisms of last resort have been set up:

-The European Stability Mechanism (ESM)

-The European Financial Stabilization Mechanism (EFSM)

The Greek Public Sector: Conditions for a sustainable size

Sustainable public finance according to the above described framework for fiscal discipline, is a crucial precondition for the country's continuing membership in the Eurozone. The sustainable size of the Greek public sector, is a cornerstone for balanced public finance and adjustment to the framework established by the new Europact.

Despite the fact that country public employment figures are not always fully comparable, due to reclassifications of certain organizations and definitions of general government, existing figures from Eurostat and OECD mirror the size and importance of public employment in the Greek economy.

The public wage bill, by its size, is not only a crucial determinant of fiscal performance but also certain qualitative features of public wage expenditure can exert important feedback effects on a country's macroeconomic performance. The Greek public sector: absorbs one of the highest percentages of GDP in total government expenditure in the Euro area and has low quality and quantity of services.

In the case of Greece, the existing strong public-private wage interaction has led to sharp unit labor cost growth, causing also public sector wage increases. The average increase of wage earnings in the private sector in Greece was more than double compared to the Euro area average, at 5% to 2% respectively.

The Problem of Performance of the Greek Public Sector

- The sustainability of the public finances is not only related to the size of the public sector, but also its performance.
- Performances in individual areas of public activity, is depended on relevant economic and social variables, as follows:

1. Administrative: Corruption, red tape, quality of judiciary, shadow economy.
2. Education: Secondary school enrollment, education achievement.
3. Health: Infant mortality, life expectancy.
4. Public infrastructure: Quality of communications, transport infrastructure.

- Areas to improve public sector's performance are related to the following policies:
- The limiting of public sector's size
- The implementation of an integrated privatization program
- Improve effectiveness of public spending plus better management
- Enhance the efficiency of the budget process
- The restructuring of the tax-collecting mechanism

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EMU, Macroeconomic Convergence and Fiscal Integration

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Greece: Tax Anything that Moves! — Professor Theodore Pelagidis

The effectiveness of the policy prescription as suggested and approved by the official lenders of the Greek government (the "troika," consisting of the European Central Bank (ECB), the International Monetary Fund (IMF), and the European Commission (EC)), as well as its implementation by the Greek government has been debated by many parties. Still, despite available research indicating the negative impact of tax increases on GDP, Greece's government debt and fiscal deficit was so high by 2009 that it could not have been tackled except through a combination of both cost-cutting and revenue-increasing measures. In addition in some areas, such as recurring property taxes, the personal income taxes, and consumption taxes when adjusted for the composition of GDP, data made available by the Organization for Economic Cooperation and Development (OECD) and the European Commission Tax Database (ECTD) clearly suggested scope for revenue increases. Focus, instead, should be given on (1) the implemented policy mix between revenue increases and expenditure cuts and (2) the role of growth-enhancing structural reforms in both the business environment and crucial network industries on the one hand, and reforms in the private sector labor market on the other.

For the Greek case, the delay in acknowledging the importance of cost-cutting measures as a crucial ingredient of success is particularly puzzling given that, from 1990 onward, both the technical reports, and the IMF Article IV reviews for Greece that accompanied these technical reports consistently refer to the inability of Greek governments to control expenditures. One can only wonder why the Greek government never warmed to the idea that a balance between expenditure reductions and tax increases, as agreed upon in the initial conditionality program, was necessary to implement the strategy of "internal devaluation" that the troika so vigorously supported. It is just as baffling that the troika expressed no concern about front-loading tax increases and postponing the cost-cutting actions in the program. Concerns about the excessive reliance on tax increases in the fiscal adjustment strategy appeared, really, only in December 2011. But even in March 2012, almost two years after the time of the initial agreement between the troika and the Greek government, there was no full assessment of the implications of the policy mix of the fiscal adjustment program.

Another major problem with the program was the absence of focus on product market reforms. Not until the fourth quarter of 2012 did the troika finally start to press the government to implement structural reforms in product markets and professional services, and to cut waste. But the damage to the productive economy had already been done. The heavy emphasis by the troika on reducing labor costs in Greece, rather than reducing administrative costs and government-sponsored restrictions on competition, is puzzling since available evidence showed that the cost of wage-earning labor was lower in Greece than in any other European country, while regulatory costs and restrictions on competition were the highest among all EU countries. Indeed, the gains from increased flexibility introduced by labor market reforms had a less positive and immediate impact owing to the predominance of highly flexible self-employment and the low share of wage-earning employment in the cost structure of the economy.

At the front of consumer prices, the fact that they do not reflect the fall of producer prices, relative to the eurozone average, even with constant taxes, demonstrates the persistence of the market distortions resulting from state interventions and the problems of scarcity and high cost of financing, the collapse of trade credit, and the increase of uncertainty in transactions between manufacturers and retailers. In addition, utilities such as water and sewage services, postal services, and railroad services, which are mainly state controlled, tend to have implemented above-average fee increases in spite of the crisis and the supposed determination of the government to reduce consumer prices.

Special Points of Interest

- 2012 analysis: product and labor market rigidities complemented each other and the state is still restricting competition on a broad range of economic activities
- Even as taxes increased and labor market reforms were implemented during 2010–12, under increasing pressure from the troika, the Greek government still tried to direct the burden of these reforms toward private sector employees, while shielding privileged groups, trade unions, and public sector employees.
- It is hoped that the troika has now recognized the futility of pushing for ever more taxes and will demand more progress on the improvement of the business environment and the privatization program, for which they are now offering extensive technical assistance. But because this assistance still has not yielded any concrete results, the delay in recognizing the importance of measures to enhance growth may yet prove to be crucial.

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EMU, Macroeconomic Convergence and Fiscal Integration

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Greece: Tax Anything that Moves! — Professor Theodore Pelagidis (cont'd)

The evolution of wages and labor costs with respect to benchmark years, such as 2000, as is favored by many analysts, cannot reflect the real issues that determine the competitiveness of a country. One reason is that, following acountry's accession to the eurozone, "convergence" of incomes was a stated EU policy. Structural programs sought to achieve this convergence often with complete disregard of the fact that the inflow of large amounts of EU money in the context of weak institutions would lead to a "Dutch disease" in the country.

On the basis of this analysis, we believe that the Greek reform agenda should include the following:

- Completion of the reform of business licensing, business park legislation, and spatial planning (currently about 40 percent complete).
- Completion of commercial trucking deregulation (currently about 50 percent complete).
- Completion of the meaningful deregulation of professional fees and mandatory services (public notaries, lawyers for larger real estate transactions, and others) and thus consolidation of the significant advances already made.
- Establishment of working one-stop shops for company startups, and gradual improvement in their operation (as the current complicated process still does not work well).
- Export facilitation mainly through administrative simplification.
- Rationalization of the complex system of fees that benefit third parties in numerous economic transactions, and that increase costs, as they are effectively adding up at each layer of production.
- Rationalization of regulation and lowering indirect taxes in the energy sector.
- More aggressive implementation of the privatization program, emphasizing assets crucial for competitiveness like ports, and not assets such as gaming licenses that do not affect productivity. The good example of the Port of Piraeus should be used as a positive benchmark.
- Identification and implementation of meaningful structural reforms of the business environment beyond the usual benchmarks. A related project with the OECD needs to receive the maximum of political support and be nurtured to success.
- Meaningful tax reform that ensures effective tax collection without resorting to unfair and unreasonable practices.
- Measures that will facilitate the immense reallocation of assets that has to happen in the country. These measures range from the rationalization of the high and uncertain taxes on transfers of property and companies to the streamlining of bankruptcy procedures in a way that will facilitate the continued operation of companies that are basically sound.
- On the European side, two issues remain crucial and may contribute significantly and positively: (1) raising the perceived threshold of exit from Europe and the eurozone by making it clear that, to use an analogy, "if California does not reach an agreement with the teachers' union, the Valley will not be kicked out of the dollar zone." Thus the productive base of the economy will no longer be the primary victim of the policy failures of the Greek governments; and (2) completing the banking union in a way that will ensure to a reasonable extent that capital that flows into Greece will not be "bailed in.

What Went Wrong in the Greek Case?

- The experience gained in Greece can be hoped to have a positive influence in shaping more efficient policies to make "internal devaluation" work better, faster, and most importantly, with much less collateral damage in the future.
- The Greek case indicates that tax increases, and in particular increases in indirect taxes that undermine competitiveness, and labor market reforms should not take precedence in the implementation of a conditionality program, with the reduction of public expenditure and product and professional market reforms left as an afterthought.
- On the contrary, especially in countries such as Greece, with obvious and significant failures of business regulation and with increased labor market flexibility as a result of widespread self-employment, concentrating predominantly on revenue increases and labor market reform will most likely worsen the depth and duration of the resulting depression.

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EMU, Economic Governance and Institutions

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Coordination of Monetary and Fiscal Policy in EMU before Accession of "Transformation" Countries—Professor Jaroslaw Kundera

The European Monetary Union (EMU) is a subject to a challenge by the present economic crises despite of single market success. The most important of all the potential benefits of monetary integration are price stability, avoidance of transaction costs, low interest rates, increased flows of international trade and capital movement. After accession into the euro area a member country lose the control over its monetary policy and the exchange rate mechanism. The theory of economic integration assumes that the European Monetary Integration is needed to safeguard the benefits of the internal market.

Thus far the experiences of euro area show that it is not asymmetrical shocks that matter the most, but rather differences in competitiveness. A monetary equilibrium element can be achieved in the euro area in the process of long term convergence, competitiveness, wages and productivity growth between members countries.

Coordination of fiscal and monetary policy

The euro crisis that started in 2008 has clearly shown that more attention has to be paid to common governance in EMU, because economic coordination between partners has not been strong enough to prevent macroeconomic and fiscal imbalances within the euro area. Therefore countries with negative balance and high public debt should adjust as well as countries with external surplus and budgetary equilibrium. In the economic crisis some countries – members of the single market must assume the role of engine of economic growth. A weak government unable to cut expenditures or raise taxes treats public debt as a residual source of finance. On the one hand governments finance budget deficits by increasing public debt, on the other hand they collect taxes to pay interest to bondholders. When governments collect taxes to pay interest payments, an excess burden is creates .

Overall, in the euro area macroeconomic stability is provided by national budgetary policies, that perform a function as shock absorbers in any single country. It seems that in time of crisis the ECB may assume a more active role to contain the euro area debt crisis, and under the conditions to undertake the necessary reforms in highly indebted countries. The common monetary policy must be joined more closely with harmonized tax policies in the member states. Public spending coordination cannot be concentrated only on the one country market and political cycle, but must take into the consideration the spillover effect on the partner countries.

The evolution of euro area before accession of transformation countries.

The worst outcome for the highly indebted euro area member countries would be to leave the euro area to accomplish devaluation of their national currencies. However, coming back to the home currency may be connected not only with administrative costs of money exchange, but also higher inflation, collapse of financial sector, a loss of credibility, and corporate defaults and separation for years from capital market.

The present crisis of the euro area shows, that euro as a currency seems to be more an element of the economic union than an element of the European Single Market. However when foreign investments are treated as alternatives to exports, some investments may be encourages by the existence of currency risks. The euro was introduced not only to enlarge economic profits from thesingle market, but also to speed up European integration towards economic union. For transformation economies joining the euro- area the decision to do should be based not only on the actual economic profits and costs of monetary union, but also on the ability and willingness of the euro area to accomplish necessary reforms.

The crisis in euro area is writing a new chapter in the history of the European integration: stop monetary integration in the present form or to proceeds to reform EMU. To save the euro more efforts has to be paid to common governance in EMU, because common institutions have not been strong enough to prevent macroeconomic and fiscal imbalances within the euro area. The EU' progress towards a more integrated structure is probably the best answer to the debt crisis in the partner countries.

Reform of the Euro Area System

- The interest payments for some countries constituted such an important part of GDP that it is often very difficult to pay them back.
- A country experiencing a budget deficit due to servicing a high interest on bonds would have great leverage on the partner countries and their strong financial integration may speak for bailing out defaulting governments.
- Monetary stability in the euro area may be threatened, when if in one or more members states the budgetary situation could lead to default.
- In connection with difficult situation in banking sector the European Commission proposed banking union among partner countries that would create a common banking supervision and guarantee deposit throughout the euro area.
- The simple way to resolve the debt problems would be of course possibility to bail out the debtor country debt with ECB money.

EMU and Economic Integration

December 2013-January 2014 March 2014, Volume 2, Issue 2

Regulatory and Financial Convergence of the National Bank of Serbia for EU Accession — Professor Tamara Milenkovic-Kerkovic

With the aim of the operational preparation of the NBS for inclusion in the European System of Central Banks, two technical assistance projects of the European Central Bank to the National Bank of Serbia were implemented titled "Needs Analysis Report of the National Bank of Serbia" in the period from September 1, 2008 to 31 May 2009, and "Strengthening the Institutional Capacities of the National Bank of Serbia" from February 2011 to December 2013. Taking into account the importance and the role of central banks in the negotiation process, the representatives of the National Bank of Serbia will take part in the new coordination structure of the Republic of Serbia for the EU accession process, and those are: the negotiating team, the Coordinating Body, the Council of the Coordination Body and Negotiating Groups, whereby the role of the NBS is crucial in areas relating to economic and monetary affairs and financial services, where it is the presiding institution within the negotiation process, as well as in the area of free movement of capital, where it is the institution second in authority.

The fulfilment of the criteria for joining the EU is followed by the obligation of meeting the criteria for entering the Eurozone, i.e. the EMU (the Maastricht criteria). Bearing in mind that price stability is defined as the main objective of the NBS, as well as that the set of instruments used by the NBS in the implementation of monetary policies is compatible with those used by the ECB, we conclude that the functions of monetary regulation is largely compatible with the function of ECB monetary regulation. However, a significant deviation of the (highest) rate of inflation from the quantitative definition of price stability and the level of the targeted inflation in the EMU indicates the area where it is necessary to take certain measures aimed at bringing inflation to the level of the reference value.

The accession to the EMU, in addition to satisfying the criteria of economic convergence, requires the harmonization of national legislation of the states with derogation, including the statutes of its national central banks,with primary and the secondary legislation of the EU. It is the so called, legal convergence, which implies the harmonization of national legislation with regard to: the independence of the central bank (Article 130 of the Treaty), the prohibition of monetary financing of the budget (Article 123 of the Treaty) and the integration of the National Central Banks (NCBs) in the Euro-system. In this regard, the provisions of the Law on NBS include the basic elements necessary to achieve legal convergence, namely: price stability is set as the main goal of the NBS, there is a high degree of functional, institutional, personnel and financial independence of the NBS, the prohibition of monetary financing and privileged access financial institutions is secured (Lucic, 2011, p. 66-71).

When it comes to the banking sector in Serbia, the amendments to the Law on Banks in 2010 and the Law on the NBS in 2012, there is a high degree of harmonization of national legislation in the field of bank supervision with the EU acquis. In accordance with the Basel Core Principles of supervision and directives of the European Union, (Capital Requirements Directive-CRD), a set of six decisions was adopted which ensure the implementation of Basel II standards. Thereby, it should be noted that the Decision on Capital Adequacy of Banks does not cover the rules for calculating the capital requirement for credit risk on the basis of securitization, due to the lack of a legal framework or the developed practice in this area in Serbia. For the same reason the standards of Basel 2.5 have not yet been introduced in Serbia, and they are planned to be introduced with Basel III. On the other hand, bearing in mind that the introduction of Basel II in Serbia was conducted at a time when the Basel Committee on Banking Supervision had already released Basel III, by the Decision on the Capital Adequacy of Banks, some of its elements have been introduced into the legal system of Serbia.For the purpose of gradual introduction of Basel III in Serbia, the NBS has adopted the Strategy for its implementation in Serbia (December, 2013), which will be implemented through three stages: a) The preparatory phase, planned for the first quarter of 2014, b) The phase of effects assessment and determination of the dynamics for implementation phase, planned to be implemented until the end of 2014, and c) Legislation drafting phase is intended for drafting the regulations by 2015, which will ensure the successful implementation of these standards in Serbia until the end of the 2019 (NBS, December 2013).

Special Points of Interest

- In addition to the entry into force and full implementation of the above Decisions implementing Basel II standards, as well as the planned activities on the introduction of Basel III standards, the amendments to the Law on the National Bank of Serbia, adopted on August 4 and November 5, 2012, according to which the Financial Institutions Supervision Department (Supervision department) was formed, have strengthened the institutional capacity of the NBS.

- The NBS has legally defined mandate to ensure and strengthen the stability of the financial system; it has the definition of financial stability; publishes by the Financial Stability Report, financial stability indicators as well as composite index of financial stability (Financial Stress Index, FSI); uses stress tests and publishes the results thereof; regulates and controls the payment system; it is authorized for the micro and macro-prudential supervision and has the Committee for Financial Stability.

EMU, Financial Integration & European Banking System

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Comparison between ECB and Other Major Central Banks (US FED, Japan)—Professor Ileana Tache

EMU could be better understood by a systematic comparison of European Central Bank (ECB) with other world's monetary authorities, such as the Federal Reserve System of US (Fed) and the Bank of Japan.

Here are some reasons for choosing these two central banks for comparison. In the US case, there are some historical similarities and it is obvious that the US federal banking system is now considerably more under pressure and scrutiny than ever before. The Fed, while an American institution, is indirectly a global policy-maker and therefore its influence is far-reaching. As regards the Bank of Japan, due to its long-time role as the source of the cheapest funding available to financial actors, it has been at the origin of stock and forex market trends for about a decade, and its interest rate policy is one of the fundamental building blocks of the carry trade with wide-reaching implications for the world economy.

The three policy goals of the Fed are maximum employment, stable prices and moderate long-term interest rates, specified since 1977 by the Federal Reserve Reform Act. Actually, as completed by the Full Employment and Balanced Growth Act of 1978, there are six goals that the Fed is trying to meet: stability in the financial system (especially as of late), price stability (fighting inflation), full employment, economic growth, interest rate stability and currency stability. Price stability is not given a bigger priority than the other goals, but policy makers must assign at least an implicit ranking to these goals. All these goals are compatible in the long run, but this is not necessarily true at every point in time. This is the reason why the Fed has never quantitatively defined any of the goals.

The Bank of Japan's goal is defined as follows: "Currency and monetary control by the Bank of Japan shall be aimed at achieving price stability, thereby contributing to the sound development of the national economy". Before this moment, the Federal Reserve Act of 1913 did not include any macroeconomic goals. Then, the Employment Act of 1946 required the federal government to promote maximum employment, production and purchasing power. This Act did not make any reference to the Fed, however it was interpreted as applying to it.

Article 2 of the Statute of the European System of Central Banks (ESCB) and of the ECB define the objective of the ECB and the ESCB as follows: "...the primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Community with a view to contributing to the achievement of the objectives of the Community as laid down in Article 2 of this Treaty. The ESCB shall act in accordance with the principle of an open market economy with free competition, favoring an efficient allocation of resources and in compliance with the principles set out in Article 4 of this Treaty."

The strategies of the three central banks derive from the goals above presented. Their main function is to conduct monetary policy to achieve the goals assigned by their respective charters.

Accountability is an important counterpart of central bank independence. The Fed is ultimately accountable to the Congress, which can modify the Federal reserve Act legislation. The Bank Japan has different reporting obligations and publishes an outline of its business operations. It submits a report on currency and monetary control to the Diet twice a year. Upon request, the Governor (or his representative) explains before the Diet committees the monetary policies and operations. The ECB's commitment to accountability is illustrated by its decision to go beyond the statutory obligations in its regular reporting. For example, the ECB publishes a Monthly Bulletin, rather than the required quarterly report and members of the Governing Council deliver speeches to address relevant topics of concern to the public. ECB has maintained a close dialogue with the European Parliament, which plays a key role in holding ECB to account.

Summing up, the Eurosystem is more decentralized than the Fed and the Bank of Japan, with more tasks left to the national central banks.

The Fed and the Bank of Japan have broader mandates than the ECB, the most encompassing being that of Fed. ECB's most important goal is the medium-term oriented price stability.

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