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EVALUATION AND ANALYSIS OF THE INDEPENDENCE OF THE BULGARIAN NATIONAL BANK FOR THE PERIOD AFTER 1990

Studied is one of the primary characteristics in the activity of the contemporary central bank – its independence from the executive power. The objective of the study is to track and analyze the degree of dependence between the behavior of BNB from one hand and the activities of the government on the other hand for two relatively determined periods – 1990-1997 and after 1997. The made quantitative estimation of the independence of the central bank is in applying the popular methodology of Al. Tzukerman. The second part of the article is devoted to the specific for Bulgaria characteristics of forming and keeping the independence of BNB before and after the introducing of the rules of the Currency Board. The complex analysis of the independence shows that it is a necessary condition for macroeconomic stability, but its achieving does not guarantee by itself an economic prosperity.

JEL: E58; E63

The current development of the financial system of Bulgaria is closely connected with the Central Bank. The forming of the trade banks and other financial links is one of the grounds for the normal functioning of the monetary and capital markets and for the carrying out of the relevant monetary policy. The other premise concerns the development and the changes in the actions of the Central Bank – Bulgarian National Bank (BNB). Actually the Central Bank is the institution that most closely contacts the bank system, having the opportunity to control it, regulate it and limit or stimulate it.

The aim of the article is to trace and analyze *the degree of dependence between the behavior of the Central Bank on one hand, and the actions of the executive power on the other*. In the economic theory and practice there exist many attempts for studying and analyzing the independence of the Central Bank and its reflection upon the macroeconomic policy in a certain country, on inflation, on the state of the exchange rate and market and on the growth of economy.¹

¹ The main study on the matter, analyzing the behavior of BNB for the time till 1996 is of *Hristov, L.* A Role for an Independent Central Bank in Transition? The Case of Bulgaria. - In: *The Bulgarian Economy: Lessons from Reform during Early Transition*, ed. by Derek C. Jones and Jeffrey Miller, Ashgate, England, 1997, 129–159. Other studies are generalized in the article of *Бальозов, З* Как независимостта на централната банка влияе върху макроикономическото развитие. – *Банков преглед*, 1992, N 2, 1-4. There is a special focus in it on the study of *Bade, R., M. Parkin.* Central Banks Low and Monetary Policy, 1988; of *Grilli, V., D. Masciandaro, G. Tabellini.* Political and Monetary Institution and Public Financial Policy in the Industrial Countries, 1993; and of *Cukerman, A., P. Kalaizidakis, L. Summers, S. Webb.* Central Bank Independence, Growth, Investment and Real Rate,

The analysis in the article is constructed on two levels:

- Quantitative evaluation of the independence of the Central Bank;
- Analysis of this independence, counting the action of the set of general and mostly specific factors, influencing its development in Bulgaria. This is done for two specified sub-periods in the economic and especially in the newest financial history of the country – the period from 1990 to the middle of 1997, and from July 1997 to 2000.

The formation of the Central Bank institution is a specific process for the different countries. It depends on historically established traditions and on the circumstances in the functioning of the financial system, as well as on the contemporary tendencies in this direction. Despite the differences, there are also common features in the functioning and development of each Central Bank. Their manifestation to some or another extent depends on the concrete condition of the real sector, the legal frame that legalizes the existence and the actions of a certain institution, as well as the traditions and the national specifics of banking.

One of the *primary characteristics* in the activity of each Central Bank is its *independence* from the executive power. The question is how in reality it is realized in a certain country and what mechanisms guarantee it. "It can be considered as a matter of strict principles or of strong mind and practical experience".² The independence of the Central Bank from the government and the other state institutions is an important factor of the macroeconomic stability, as far as it concerns the degree of expansion of money and credit and through them influences the behavior of important macroeconomic variables, like inflation and the size of the budget deficit.³

Evaluation of the Independence of BNB according to the Actions of the Executive Power for the Period 1990-1999

Regarding measuring the degree of independence of the Central Bank, there is in the economic literature, a popular and practically applicable methodology suggested by Alex Cucierman (co-author with Steven Webb and

1993. In their bigger part the institutional criteria of independence of the Central Bank, suggested in chapter 2 of the study, are similar to those, studied by Z. Baliozov. Attention deserve also the articles of N. Mitcheva – head of Department "State Credits" ("State Securities") in "Bank Review" journal 1993-1995 – State Securities Insure Transparency of the Management of the State Debt, 1993, N 1, 1-6; Central Bank as a Financial Agent of the Government, 1995, N 2, 1-5. Basic studies on the matter of the independence of the Central Bank are: *Cucierman, A., St. Webb and B. Neyapti*. Measuring the Independence of Central Banks and Its Effect on Policy Outcomes. - The World Bank Economic Review, 1992, Vol. 6, N 3, 353-398; *Alesina, A., L. Summerris*. Central Bank Independence and Macroeconomic Performance: Some Comparative Evidence. - Journal of Money, Credit and Banking, May 1993, Vol. 25, N 2, 152-162, and others.

² *Titmeyer, H.* The Independent Central Bank in Europe. - Bank Review, 1991, N 1, p. 22.

³ See *Cucierman, A., St. Webb and B. Neyapti*. Op. cit., p. 354.

Billin Neyapti in his article “Measuring the Independence of Central Banks and Its Effect on Policy Outcomes”).⁴ Based on the methodology in the article, the study below is specified into two directions. First, evaluation of the purely formal (institutional) independence of the bank, based on legal rules and documents, and second, an attempt for applying the so-called informal criterion for calculating an index of the independence of the Central Bank.

Evaluation of the Independence of the Central Bank from the Executive Power in Legal Aspect.

When forming the indexes for juridical (institutional) independence, Cucierman and co-authors use relatively narrow but notably precise juridical characteristics and only officially documented information. The indexes for the choosing, dismissing and the time of engagement of the high leading staff of the Central Bank or its Manager are also developed in these limits - the indexes for the way of solving the conflicts between the bank and the government and the participation of the Central Bank institution in the formation and execution of the budget; indexes for the macroeconomic objectives, declared and followed by the Central Bank; indexes for its limitations to credit the public sector.

For Bulgaria, according to these variables and based on the formulations in both of the laws for BNB, the aggregated variables – coefficients (indexes) for the juridical independence have the following meanings:

- For the period 1990-1997 (July) the coefficient has the value of *0.489177*. Developed countries with similar coefficients are Denmark – 0.50 and USA – 0.48. In the group of the classified as developing countries, Bulgaria can be compared with Egypt – 0.49 and Costa Rika – 0.47. They are also the first two countries in this group, with highest degree of independence.

- For the period after the middle of 1997 and most of all based on the formulations in the Law for BNB, the meaning of the coefficient is *0.681125*. The level is too close to the top of the classification of Cucierman and to this of the German Central Bank – 0.69.⁵

The two meanings of the coefficient for the juridical independence for Bulgaria are some of the highest according to the published analyses of the other countries. In these calculations and the comparisons with other countries the following should be kept in mind:

- The analysis is *too abstract and subjective*. Most of the used indexes in the scale are in too “equal other conditions”, which does not allow to range as a whole the observed processes and phenomena. The subjectiveness and the limitation come from the fact that, when giving relevant number meanings to the

⁴ Cucierman, A., *St. Webb and B. Neyapti*. Op. cit.

⁵ *Ibid*, p. 362.

different indexes, the suggested degrees are between three and four, for example: meaning 1; 0.66; 0.33 and 0.00.

- The ranging of the variables is according to the formulations of the Laws for BNB from 1991 and 1997. It is quite possible, even with very precise laws, to observe *serious diversions* in the practice, provoked by the realization of short-term and situation interests of the governing political powers. For some of them cannot be made a reliable examinations and analyses since there are no published official data or untrue and even misleading information was deliberately presented. This is true even when the law is sufficiently explicit but the reality is much more different and its application is difficult and almost impossible.

- The article of Cucierman deals with the 80s when the tendencies of increasing the independence of the Central Banks are marked, but they are developed much better in the 90s. This would mean that in a new study with the same methodology there would be also higher meanings of the coefficients for the countries observed there. According to us in these circumstances Bulgaria would also acquire a *more realistic place* by going lower in the classification, especially for the period till the middle of 1997.

- After the acceptance of the Law from 1997 and the introducing of a Currency Board, as well as the observing of the bank environment and most of all the actions of BNB, the meaning of the second coefficient – 0.681125 can be accepted as more realistic. Its closeness to this of the *Deutsche Bundesbank* can be explained with the orientation and following of the European and mainly German practice in the legal limiting of the central banking, as well as with the use of the German Mark as a basic reserve currency, or (since 1999) the EURO, which is strongly dependable on it. In this sense the Currency Board is one of the most serious factors increasing and guaranteeing the independence of the Central bank.

Informal Indicators for Measuring the Independence of the Central Bank

As a first level of the analysis of the informal criteria of independence of the Central Bank, Cucierman, Webb and Neyapti suggest the period of the managers turnover. It is logical that the more frequent change will generate greater degree of dependency of the behavior of the institution. But it is possible to choose manager, who is sufficiently acceptable for all dominating political powers, and he can stay for a long time at the head of the bank. The acceptability can be examined in two aspects:

- This must be a well known, independent financially and politically person, with high authority in the financial world who is able to stand his positions under any attempts for pressure.

- The chosen manager to be lacking individuality and be inclined to take into consideration the recommendations and pretensions of the executive power. If

the country does not suffer substantial economic and political crashes, which would impose an immediate change in the policy of the Central Bank, such manager can stay without problems for a long time on his position, and the changes in the political dominants would reflect on the staff of the Board of Directors and the way of its composing.

For the period 1990-1997 there are two changes of the BNB managers. In these circumstances for the first sub-period the average annual rate of change of the manager is 0.29 (two managers for 7 years 1991-1996 incl.), for the second sub-period – 1997-2000 – 0.25 (one manager for 4 full years from the middle of 1997 to the middle of 2000), and for 1990-2000 – 0.27. For comparison⁶ – the highest rate of change of the manager of the Central Bank for the period 1950-1989 is 0.2 for Spain among the industrial countries, which means average change every 5 years. Most of the half of the observed developing countries have had rates higher than 0.2. Most impressive in this connection is the situation in Argentina, where the rate is 0.93, i.e. the change has been every 13 months.

This way of examination and analysis of the independence of the Central Bank must be followed also by accounting for the many other factors, which are related to it. This imposes, at a second level, the use of the so-called informal approach, based on the suggested by Cucierman and co-authors Questionnaire with variables, weights and number meanings (codes).⁷

Based on the suggested by Cucierman and co-authors methodology, for the two periods, here are the values of the coefficient/index of independence:

- For the period 1990 – July 1997 the coefficient of the degree of independence, called by the authors of the article an index, based on the questionnaire, is 0.22425. This value puts Bulgaria at one of the last places in the world, compared with the data from table 5 in the quoted material.⁸

- For the period from *the middle of 1997 to 2000* the value of the index is 0.849 – putting the country at one of the first places among the examined

⁶ According to the data in table 3 from the article of *Cucierman, A., St. Webb and B. Neyapti*, p. 364.

⁷ The questionnaire, suggested by Cucierman and co-authors, has been sent to some representatives of the Central Banks of the examined countries. The calculations are made on the basis of their subjective evaluations for the revealing of the mentioned variables. In our study it was mainly the author, who by consulting some former and present employees of the Central Bank, filled in the questionnaire.

⁸ The table ranges the period 1980-1989 and the index is compared with the average annual percentage of inflation in the relevant country. The number of the examined countries is 23. On top of the table, with index 1.00 is Germany, followed by Costa Rica with index 0.81, Finland – 0.78, etc. On the bottom of the table is Peru – 0.22, Yugoslavia – 0.17 and Ethiopia – 0.13. See *Cucierman, A., St. Webb and B. Neyapti*. Op. cit., p. 368.

countries. The high value of the index is due mainly to the strict restrictions, which the Currency Board imposes to the Central Bank in its connections with the executive power, as well as in the impossibility to manipulate with the money supply in favor of the economy as a whole or different branches of it. This result allows us to think that independence and stability in the functioning of the bank is achieved to a great degree.

The metrification of the independence of the Central Bank by the suggested methodology is one of the approaches for its evaluation and analysis, which focuses mostly on the general characteristics or repeating in a group of countries phenomena. Its applying and the shown results in the quoted article concern countries, which generally do not face the questions of transition to market economy, forming a market-oriented financial system and public finances, or overcoming inherited by the central planning dependencies and way of behavior. In this sense the approach of Cucierman and co-authors can be added also with the analysis of the specifics of functioning of BNB and mostly of its interrelations with the executive power.

Specific Characteristics of the Forming and Maintaining the Independence of BNB from the Executive Power

The defect of the mostly formal (as juridical) type analyses is in the possibility of difference between the defined in the law and the normative documents situations and the practice, since: the normative order is not precise, or despite the correct formulation of the main relations Government – Central Bank it is still acted by the tradition and not following the law. Most suitable is the combined type of analysis, including the institutional as well as the economic aspects of the independence.

Institutional Indexes

To the *institutional indexes* (of political and juridical type), which give opportunity to draw the specifics in the relations BNB – government, can be classified and analyzed the following ones:

- *The Rights of the Government to Interfere in the Forming and Directing Funds from the Budget of the Bank.*

This index is examined mostly as political and not as purely economic, since it is a reflection of the rights of the executive power to model the frame, in which the Central Bank exercises its activity. In Bulgaria for the time after 1990 there is not and there has not been a legal regulation of such rights of the government towards BNB. According to the Law for BNB from 1991, the budget of the institution is accepted by the Plenary Council, which existed till 01.07.1997 and its execution is approved together with its annual report by the Parliament. The new Law for BNB (1997) determines Parliament as the body that approves the annual budget of the bank and accepts the

report for its execution. The costs for the management of the bank are realized in the existence of relevant decisions of the Manager or the delegated sub-manager.⁹

- *The Right of the Executive Power to Influence the Determining of the Salaries of the Employees of the Bank, Especially the Members of the Board of Directors.*

In this direction BNB can be considered as independent from the government decisions, since the rewards in it are regulated by the law on its functioning (for both examined periods). They are determined and corrected by the Board of Directors and the criterion is that "it cannot be lower than the average reward of employees in the relevant functions in other banks in the country".¹⁰ Thus a sufficient level of paying in the bank is guaranteed, which keeps the employed labor force and compensates its work efforts. In the structure of the current costs of BNB, the share of the costs for salaries, social securities and other social activities in the frames of the bank has been with maximal value 29,4% (1998) and minimal 11,22% (1992) and the level of the gross compensating for the employees of BNB is higher than this for the country as a whole as well as compared with the employed in the financial system (department "Finances, Credit and Insurance") for the period till 1996 included. In the absence of serious breakings in the normative order of the labor rewards in the state sector, it can be considered that the Board of Directors of BNB has determined the salaries and the social insurance in accordance to the requirements of the Laws for BNB and despite the executive power. Since 1997 BNB does not publish official data on the number of its employees.

- *Participation of the Government with Share in the Profit from the Bank Activity, if Any.*

According to the previous and current normative order, the government has no share in the profit of BNB, since the latter is an institution that does not work for profit. The Laws for BNB do not even use the term profit, but rather annual surplus of the incomes over the costs, which is directed to a "Reserve" Fund of the bank – 25%, to the funds with special application, established with a decision of the Board of Directors. The rest of the annual surplus is brought in the state budget. The dynamics of this index since 1991 is shown on Table 1.

⁹ See Law for the Bulgarian National Bank. - Държавен вестник, 1991, N 50, changed in N 32, 16.04.1996, chapter VIII; and the Law for BNB. - Държавен вестник, N 46, 10.06.1997, chapter VIII.

¹⁰ Law for BNB. – Държавен вестник, N 46, 10.06.1997, chapter III, art. 23, line (3).

Table 1

Results from the Activity of BNB (billion levs)

	1991	1992	1993	1994	1995	1996	1997	1998	1999(3)
Total volume of the income from the activity of BNB	15.529	11.446	20.680	75.479	153.936	524.225	1441.212	253.325	243.351
Size of the surplus of the income over the costs	6.910	2.122	12.411	28.912	18.459	137.246	264.790	123.581	184.688
In % from the total income	44	19	60	38	12	26	18.37	48.78	74.67
Amount the pay to the budget (1):	4.701	1.570	9.184	21.395	13.660	23.545	195.945	91.450	136.699
In % from the surplus	68	74	74	74	74	17	74	74	74
Share of the BNB pay to the budget (% from the income)	5.5	1.9	7.8	9.7	4.2	4.1	3.54	1.13	1.44

(1) This amount is according to the report for the income and costs of BNB and not as it is reported in the data about the cash execution of the state budget, section "Non-Tax Incomes". In most of the years in the period (1991-1997) there are preliminary amounts paid to the budget.

(2) The net income in the consolidated state budget for the relevant year is used as a base, except for 1999 when the gross income is used.

(3) The data are in million levs.

Source: Annual reports of BNB for the relevant years.

For the examined period (1992-1999) the pay to the consolidated state budget as a percentage from the net income averaged 4,37% - an insignificant share, which does not give reasons to consider that the government in this way is seriously bound and dependent on the bank. On the other hand, from the total volume of the surplus average about 62% have gone to the state budget, which is completely in accordance with the declared position of the bank that it is not an organization, oriented to profit.

The above factors reveal not only political but also to a certain extent the financial aspects of the independence of the Central Bank concerning the executive power. Even if there are some regulations concerning the budget of the Central Bank or a requirement for bringing in the state budget of the whole profit, as it is according to the Law for BNB, still there cannot be drawn a conclusion for the presence of a strong dependence. In this aspect of the criteria for independence between the nominal and real results in BNB, there is no substantial difference, which determines also its political independence.

Some other indexes should be put in the group of the institutional criteria also and they give a better picture about that to what extent the Central Bank really works alone and separately from the government bodies:

- *Opportunity of the Government to Appoint or Dismiss Members of the Board of Directors.*

Such opportunity does not exist according to all accepted after 1990 laws for BNB. Both normative acts regulate the election of the manager and the three sub-managers by Parliament, and the appointment of the other members of the Board of Directors by the President of the Republic. Also the dismissing or resignation requesting is a right of the Parliament and happens in accordance with the regulated by law cases, in which a person cannot or does not want to follow his obligations. What parliament practice shows in Bulgaria is not fully in accordance with the law order and the mentioned above. Usually *the choice of one or another Manager of BNB and the relevant Board of Directors is strongly supported by and dependent on a certain political power that has a majority of votes* and hence real chances to succeed. An example in this sense is the Law on Changes and Additions of the Law for BNB accepted on 02.04.1996 by Parliament. According to it the manager and the sub-managers of the bank can be replaced with 60% of the votes of the present people's representatives. Thus in the management of the financial sector are indirectly reflected the short-term interests of certain political powers, which can go into a conflict with the long-term objectives of the growth of the country and the relevant stability of the financial system.

- *Time of the Term of the Manager and the Members of the Board of Directors of the Bank.*

According to the Law for BNB from 1991 it is 5 years and according to the Law from 1997 – 6 years. The longer the term of the managing body is, the less exposed it will be to influences by the executive power. Also the construction of the Board of Directors and the change of the manager of the bank are to be in years that do not match or do not follow directly the years of Parliament elections and appointment of new Government.

The new Law for BNB and the practice after 1997 focus on the increase of the independence of the bank from the government by introducing additional protection mechanisms against illegal actions of the Board of Directors. The three members appointed by the President and those who are elected by the Parliament have different term,¹¹ with which a rotation principle is applied for the larger part of the Board.

- *Presence of Government Representatives in the Board of Directors of the Bank.*

The history of the central banking in Bulgaria knows situations where there is a government delegate, agent or a person with a similar status who participates

¹¹ The elected by the Parliament in 1997 with the new Law on BNB manager of BNB S. Gavriiski and sub-manager M. Zaimov (Emission Management) have a term of 6 years; the sub-manager Assoc. Prof. E. Milanova (Bank Monitoring) – 4 years; sub-manager V. Tsvetanov (Bank Management) – 2 years, replaced in 1999 by B. Kabakchiev. The appointed with Decree 230 by President P. Stoyanov members of the Board of Directors are with terms as follows: P. Avramov – 5 years, Prof. G. Minassian – 3 years and Prof. G. Petrov – 1 year, re-appointed after their terms expire.

actively in the work of the Board of Directors, following the interests of the executive power. Now this process of delegating certain people in the managing body nominally is not allowed. There are no restrictions or the so-called “sanitary period”, in which former high employees of the bank should not participate in certain economic or political structures related to the Central Bank, like trade banks or similar financial institutions.

These legally non-precise situations give an opportunity informally but to a significant extent to carry through certain party interests, or interests of economic groups. The pressure over the Board of Directors can lead to misusages of the opportunities of the bank, such as too high non-covered credits for the government, as the analyses of the data from the tables in the indexes for the economic measurements of the independence show.

- *The Government Makes the Final Decisions on the Carrying Out of One or Another Type of a Monetary Policy.*

According to the both analyzed laws for BNB, the decisions and the carrying out of the monetary policy is a right of the Central Bank. It has to observe and correct the dynamics of the money supply, the interest rates and the exchange rate, as well as the macro-variables connected with them – credits, savings, prices and others. In a normal economic situation the money supply should be sufficient for the needs of the economic turnover and slightly should exceed it, thus stimulating the deals and activating the economic subjects.

The practice from the first (1990-1997) years of the transition in Bulgaria shows that in fact the Central Bank has been directly subordinated to the government and has followed its policy and its own strict rules. Evidences are the many direct credits of the government since 1996 (see table 3). Thus in practice the monetary policy has in reality been determined by the government, without it having a normative reasons for this. If the independence of BNB should be evaluated by this index, the evaluation should be strongly negative, putting the Central Bank and the country in the group with the most strongly dependent to the government monetary institutions.

Economic Indexes

Besides the institutional (political) aspects, the independence of the Central Bank from the government has also a purely *economic (functional)* sides related to the mutual money flows, which flow between the two institutions. The question is not about the above-mentioned budget payments from the BNB incomes, since this is rather a political act, not opposing the world practice. *The economic criterion*, on which the independence of a certain Central Bank can be evaluated, is complex. It includes:

- *Opportunities for the Government to Receive Covered and Non-Covered Credits from BNB and the Question of the Volume of these Credits.*

The restrictions to the Central Bank to give non-covered credits are regulated in the laws on its activity. According to the Law for BNB from 1991 it “can

give to the state temporary credits (advances) with payment term up to 3 months but not later than the end of the calendar year. The maximal amount of the temporary credits, which can be not repaid at any moment, cannot be bigger than 5% of the annual income of the state budget, as well as bigger than the amount of the brought in fixed capital and the funds for the "Reserve" Fund".¹²

The Law for BNB accepted in June 1997 totally limits the opportunity to give credits to the state, except for buying Special Drawing Rights (SDR) from the International Monetary Fund. It states: "The Bulgarian National Bank cannot give credits in any form to the state or to state institutions, except credits for buying Special Drawing Rights from the International Monetary Fund, given by the Board of Directors under the following conditions:

1. The decision of the Board of Directors to be made not later than 7 days after the date of the purchase of special drawing rights from the International Monetary Fund.

2. The time for using the credit by the state is up to 90 days after the date of the purchase of special drawing rights from the International Monetary Fund.

3. The payments on the principal and the interests are made in terms not later than the dates, on which the relevant payments by the Bulgarian National Bank to the International Monetary Fund should be made, and this should be done in the necessary for the payments volumes.

(2) After the end of the term on art. 1, p. 2 the right of the state upon the unused part of the allowed credit is covered."¹³

The correct quoting of the law above aims to set as a prerequisite the critical analysis of the new formulation of the relations Central Bank – Government. The obligations to IMF to buy SDR for the quota in the organization, force the government, if it does not have other resources, to ask and to have the right to receive strictly regulated credit with restrictive covenants from BNB, which practically serves the connection of the credit receiver (the government) with the creditor (IMF).

The first of the two observed sub-periods – 1990-1997 – is characterized with mass crediting of the executive power from BNB. Typical in this sense is the practice from the beginning of 1996 to May 1997. In the given direct credits to the government on the relevant laws for the state budget, BNB has the predominant share of about 95-98%, compared with the other creditors – the trade banks. Evidence for this are also the quarterly data of the BNB statistics (see Table 2).

¹² Law for the Bulgarian National Bank. - Държавен вестник, 1991, N 50, changed N 32, 16.04.1996, chapter 7, art. 46.

¹³ Law for Bulgarian National Bank. – Държавен вестник, N 46, 10.06.1997, chapter 7, art. 45.

Table 2

Direct Credits to the Government according to Law on the State Budget for the Period 1996 – June 1997

Quarters	Total volume of given direct credits, mln. Levs	Share of BNB in them, %	Share of trade banks in them, %
I quarter of 1996	106587.0	95.85	4.15
II quarter of 1996	93153.0	95.45	4.55
III quarter of 1996	129870.0	96.88	3.12
IV quarter of 1996	237817.0	98.38	1.62
Total given credits for 1996	567427.0	97.98	2.02
Credit debts to 31.12.1996	139325.7	99.09	0.91
I quarter of 1997	428356.0	99.14	0.86
II quarter of 1997	346657.0	98.99	0.01
Credit debts to 31.06.1997	1144436.5	99.90	0.10
III quarter of 1997	3288.0	0.00	100.00

Source: BNB, monthly and annual statistics.

The debt to BNB accumulated till the end of June 1997 is on a loan, given for buying SDR. It is formed on the basis of the approved in 1997 Law for BNB, paragraph 10 from the final and concluding orders, saying: "In deadline up to 14 days after the legalization of the law the takings of the Bulgarian National Bank from the state, as well as other bank assets connected with debts of the state to foreign creditors, are reconstructed according to contracts, signed between the Manager of the bank and the Minister of Finances."¹⁴ Therefore, this accumulated debt counts all debts of the state to BNB, formed concerning its relations with the world organizations and mainly IMF. The debts on all other short-term and long-term credits given to the government to this date are covered.

The practice to give direct credits to the Government from the Central Bank is a serious threat for the stability of the monetary sphere. They are especially fatal for the condition of the monetary and the real sector for the months December 1996 and January – May 1997, when BNB increasingly credited the state, with which additionally burdened the inflation background in the country and increased the inflation expectations. An evidence for this is the dynamics of the prices, as well as of the exchange rate of the lev towards the USD. The exchange rate of the lev towards the USD and the dynamics of the consumer prices for the period May 1996 – June 1997 have clearly revealed a parallel in the movement. For example, for the period November – December 1996 the lev has been devaluated from

¹⁴ Ibid., paragraph 10 from the final and concluding orders.

283.39 levs for 1 USD to 461.16 levs for 1 USD, with a change of the consumer prices of 26,94% for December, compared with November. The change of the average monthly exchange rate of the lev and of the consumer prices since the beginning of 1997 is shown in Table 3.

Table 3

1997	Average monthly exchange rate towards the US dollar	Change of consumer prices compared with the previous month, %
January	698.65	43.54
February	2387.16	242.71
March	1660.07	12.27
April	1547.23	- 0.70
May	1532.63	5.65
June	1668.45	0.82

Source. BNB, Information Bulletin, 1999, N 9, p. 21, 40.

- *Degree of BNB Control over the Instruments of the Monetary Policy.*

The main instruments of monetary policy, applied by BNB, are the classical obligatory minimal reserves, refinancing of the trade banks and the operations on the open monetary market. Concerning the degree of commitment and independence between the Central Bank institution and the Government, it is interesting to see to what extent in the motivation of one or another intervention BNB has been:

- alone in making the decisions;
- able to control the application of the relevant measures;
- influenced in its decisions and relevant measures by the fiscal and other actions of the government.

The independence of the BNB in the decisions on the monetary policy is nominally regulated with the Laws for BNB from 1991 and 1997, chapter III "Relations between the Bulgarian National Bank and the State". In article 47 of the first law and article 44 of the second one it is especially stated that "the Bank is independent from instructions of the Council of Ministers and other state bodies when executing its activity".¹⁵ But in reality, especially in the period till July 1997, the activity of BNB to some or another degree has depended on the decisions of the Government, directed to controlling and regulating the state of different areas of the economy or of the whole macro environment. This reflects substantially the monetary policy of the bank, since it is in conflict with its intentions to depress the inflation sources and to maintain the internal and external stability of the national

¹⁵ Law on Bulgarian National Bank. – Държавен вестник, 1991, N 50, changed in N 32, 16.04.1996; and Law on BNB. – Държавен вестник, N 46, 10.06.1997.

currency, in condition that the fiscal and income policies carried out by the Government are not sufficiently restrictive.¹⁶

The accepting of the Law on Arranging the Non-served Credits (LANC) in December 1993 forces BNB to expand the refinancing of the two most burdened with LANC bonds banks – the Economic Bank and Mineralbank (1995). This is reflected most negatively on the dynamics of the money supply since BNB loses control over the money base. In 1996 the problems with the crediting of the state budget as well as the too liberal budget discipline and practice put a strong pressure for decreasing the restrictiveness of the monetary policy. Even at the end of the year BNB was forced to give 115 billions direct credit to the Government with term for covering 20 years and with 5 years free period. In this sense the conclusion, made in the annual report of the bank state: “The analysis of the sources for increasing the reserve money clearly shows that in 1996 the Central Bank could not match its main goal to maintain the stability of the lev with the additional goal – to maintain the stability of the bank system. A role for this plays also the pressure for financing the fast growing budget deficit, which made the reserve money weak to manage and the monetary policy – ineffective.”¹⁷ This is reasonable and is an official confirmation of the high extent of instability and dependence of the BNB activity.

In 1997 with the passing of the Law for BNB and the introducing of the Currency Board a *substantial step towards the independence of the Central Bank* is made. Evidences in this sense are the strict regulation for not giving direct credits to the government except in mentioned case, as well as the separating of the Emission from the Bank Department into separate balances and the guaranteeing of considerable independence (separate balance) of the Emission Department in the frames of BNB.

The specificity of the Currency Board in Bulgaria allows also a deposit of the Government in the Emission Department. This allows the government “... to manipulate the money supply through its deposit in the liabilities of the Emission Department. The movement of this deposit can be interpreted as an *index (measure) for the monetary policy of the government* and is a buffer between the changes of the money base and the dynamics of the foreign currency reserves. The increase of this deposit limits the reserve money...”¹⁸ and the practical independence of the Central Bank in making decisions concerning the ways, in which it can imply the available instruments of the monetary policy.

- *Type and Quality of the Portfolio of National State Securities (SS) Held by the Central Bank.*

¹⁶ BNB. Annual Report. 1993, S., 1994, p. 51.

¹⁷ BNB. Annual Report. 1996, S., 1997, p. 70.

¹⁸ *Nenovski, N., K. Hristov.* Financial Repression and Rationing of the Credit in the Conditions of Currency Board in Bulgaria. - In: Discussion Papers, 1998, N 2, Publishing House of BNB, p. 18.

In the first years of the transition, BNB gave to the Government non-covered unsecured credits. The first short-term government securities (GS) BNB acquired in the beginning of 1993 and long-term ones – in December 1993.

Table 4

Structure of the Secured Debt of the Government to BNB, 1993-1994,
mln. levs

Months	1993		1994	
	Short-term GS	Long-term GS	Short-term GS	Long-term GS
January	46	0	822	0
February	29	0	530	0
March	110	0	2338	930
April	2123	0	3663	1125
May	410	0	3727	930
June	420	0	2941	1141
July	50	0	152	1146
August	958	0	2230	5841
September	369	0	172	9581
October	1521	0	2735	5828
November	1233	0	1501	702
December	1866	200	3324	9698

Source: BNB, Information Bulletins for the relevant years.

The dynamics by months of the acquired from BNB in 1993-1994 Government securities shows a sustainable tendency towards replacing the short-term with long-term bonds. It continues also during the following years. For example, in 1995 a direct debt of the Government to BNB in the amount of 10021.96 million levs is secured – through four exclusive emissions of 9-year treasure bonds. In 1996, according to the information on the sources of reserve money, to the end of the second and third quarters there is a net increase of the Government securities held by BNB. During the third quarter by insistence of the government BNB buys LANC bonds from ailing trade banks in order to improve their liquidity and the net accumulation of GS in its portfolio is 215.1 billion levs. To the end of the year the bank holds GS for 169.464 billion levs, from which predominant part are middle- and long-term ones.

- *Freeing BNB from Obligations that Are Not Directly Connected with the Monetary Policy.*

When estimating the independence of BNB by this index it is proper to observe to what extent it is not connected with *direct* serving the population and the economy. The first step towards freeing BNB from

bank serving of the economy is the conversion of its branches into 67 trade banks (1990). The new bank structure allows transferring the takings and debts to the functioning enterprises at that time towards the newly established banks and the Central Bank to be freed from the worry for their financial support. In the balance of BNB until 31.12.1990 in the assets the bank maintains securities from participation in banks and companies. Their share in the assets of the bank is 2,5% and is equal to this of Fund "Co-Participations in Banks and Companies" from its liabilities. According to the report this is the size of the kept by BNB participations as a shareholder in the state banks in the amount of 846,4 million levs.¹⁹ With this legal act the bank is separated from the real sector, maintaining only its connections with the budget on the administrative serving of the public finances.

The process of freeing BNB from obligations not connected with the public finances continues in 1991 with the accepting of the Law for BNB. This foundation establishing for the bank system normative act gives a right to BNB to accept from "... the Council of Ministers and the municipalities money deposits on the current and deposit accounts, in conditions announced by the Board of Directors".²⁰ Chapter VII of the same law determines the bank as an official depositor of the state money funds as well as the organization and execution of the budget cash providing – a traditional function of BNB.

Despite the legal reasoning it can be stated that for a mid-term period (till the middle of 1997) BNB maintains indirect connections with the real sector. They are revealed in the support of banks, burdened with non-served credits given to the state enterprises. Another aspect of these indirect engagements are the connections with the Government in solving economic and social problems in the public sector – in the different branches of the budget sphere. An evidence for this type of interrelations are the direct credits given to the state till June 1997, as well as the mass refinancing of the trade banks, the operations on the "saving" of the Economic Bank, of Mineralbank (1994-1996) and other branches of the system, suffering failures. BNB participates also as a main executor together with the Bank Consolidation Company in the initiated by the Ministry of Economic Development "Program for Stabilization of the Bank System" (1995). The interrelations of BNB with the state and the trade banks become more precise and are changed significantly in some directions with the new Law for BNB (1997). After its approval it can be stated that the premises for direct connections of the bank with the real sector are finally abolished and in this sense it is independent in its monetary activity.

Still the right of BNB to issue and manage securities on behalf of the state remains, for which it keeps also a register. This function is contracted in advance

¹⁹ BNB. Annual Report. 1990, S., 1991, p. 51.

²⁰ Law for the Bulgarian National Bank. – Държавен вестник, N 50, 1991; changed N 32, 16.04.1996, art. 38, line (1).

with the Minister of Finances and the issued securities are offered for public emission. The Bank is also engaged in the central department and its branches to sell GS. It also publishes a detailed information about the type and term of the emissions of securities. In realizing significant for the state financially-credit operations – for example forming and serving of the official foreign debt – the bank can be and is used as a representative of the Council of Ministers. An example in this direction is the connections of the Government with the International Monetary Fund and other international organizations that pass through the balances of the bank.

In conclusion, in the past period – 1990-1999 – for the time till 1997 BNB has not always been free from obligations that are not directly connected with its monetary policy. Till the introduction of the disciplinary for the bank system and the Central Bank measure – the Currency Board – a part of the failures of BNB as a main monetary institution, engaged with the regulating and monitoring of the monetary sector, are due to its direct and mostly indirect engagement with some untypical monetary activities. The positive changes from the middle of 1997 give reasons to think that now, by this index it can be classified as a considerably independent institution and a Central Bank of a modern type.

- *Independence of the Interest Policy of BNB Concerning the Credits to the Government and the Determining of Main Interest Rate (MIR).*

The dynamics of the interest rates is one of the possible concrete objectives that the Central Bank can choose when carrying out a monetary policy. The independence in the determining of the interest rates and the changes in them can be examined as a substantial measurer of the independence of the Central Bank. According to the Law for BNB acting till 1997, the Central Bank determines the main interest rate (MIR), which is also the price of the so-called Lombard credits. MIR is an administrative price of short-term credit covered with GS, which influences the behavior of the trade banks, as well as reflects on the price of the debts, formed by the state. On the other hand, the practice in Bulgaria is that the payments on the debts of the state are connected with the dynamics of MIR.

After the introducing of a Currency Board, BNB does not determine the main interest rate. It has the task only to announce it publicly but it is formed based on the three-month GS profitability, acquired on the market. For the two years existence of the Currency Board, it has not been necessary for the bank to refinance the failing trade banks. The Law regulates only the acceptable terms and the amount of the credit – not more than 3 months, with stake with high liquidity – gold, foreign currency or similar quick-liquidated assets. As a whole for the system the possible refinancing is in the size of the deposit of the Bank Department in the Emission one.

- *Influence of the Government on the Type and the Price of the Credits Given by the Trade Banks.*

It cannot be stated that the Government has influenced directly the determining of the type and price of the loans given by the trade banks to the real sector. On the contrary, seemingly it keeps neutrality in this direction, but in reality some conclusions about an indirect interference can be made, based on the following facts:

- For the period 1990-1997, when BNB carries out a definitely discrete monetary policy, the manipulations with MIR reflect the intentions most of all of the central Bank to limit the too much and unreasonable credit-giving of the trade banks, as well as the generating of an inflation pressure on the prices. Only in the procedure handling the non-served credits the executive power imposes to the trade banks—creditors a price equal to MIR. In the same period as resource sources for supporting the suffering financial branches the big trade banks and mostly DSK and Bulbank are used. This administrative crediting among the cross-bank market is a signal for influence of the Government on the credit flows in the economy.

- In the conditions of the Currency Board BNB determines only the methodology of calculating the MIR. Practically it is influenced by the acquired profitability from the initial auctions of the three-month GS. Its keeping to a low level through limited supply of the relevant GS reflects not only the credit relations of the Government but also the trade banks that are influenced by the MIR in the pricing of the deposits too. On the other hand, the practice of the trade banks is to ask for a price for the credits given by them of between 15-20%, since they have too high bonuses for the risk and pessimistic estimations for the return of the invested resource in the real sector. A better version for a basic rate is this of the cross-bank market of deposits, under the condition that this segment of the credit markets functions normally.

Conclusion

The study of the independence of BNB from the executive power shows *contradictory results* that are a reflection also of the uncertainty of the economic practice and the difficulties generated from the transition to a market economy.

From the point of view of the failures in the real sector there are serious reasons for a *doubt in the reliability of the high values of the coefficient of legal independence especially for the period till the middle of 1997*. They are provoked by the impossibility in the transition economy the Central Bank, which 50 years has been an ordinary trade bank totally subordinated to the executive power, for a very short period to be transformed into institution totally independent from the Government.

But the high values of juridical independence are a proof also for the fact that the laws have been and are formulated well. Their breaking has a subjective character. It is one of the reasons for the failures on the first place of the financial sector and on the second place - of the whole economy. The Currency Board, as an institution provoking a trust in the financial authorities, acts as a factor,

guaranteeing the observing of the laws and therefore maintaining in a legal aspect the independence of the bank. The problem, which the macroeconomic policy and practice, is whether it is possible for the Board to generate sufficiently reliable mechanisms that will maintain these results even after it is gone? Even with a functioning Currency Board, the automatism in the action of the “solid” monetary rule for the money supply does not assure mechanisms for protection of the internal and external shocks.²¹

The change in the values of the coefficients in the applying of the informal criterion is explainable. It is confirmed also by the conducted analysis of the set of specific for the Bulgarian reality institutional and economic factors, influencing the independence of BNB. The giving of direct credits to the Government damages its emission policy since it imposes an additional paper-money emission that increases the money base and the money supply to the economy. If there are unemployed resources in the economy and it is in the phase of revival or is coming out of depression, an additional emission would ease the economic subjects and would encourage them towards business initiatives, leading to an increase of the employment and incomes in the economy. But if the loans from the Central Bank cover past debts to the budget or are for rewards and other costs in the state enterprises, which really do not work, then this crediting is a pure pro-inflation factor. It is also a confirmation of the low degree of independence of BNB from the government and the connected with the state authority institutions. *The severely damaged independence of BNB from the executive power in the period 1990-1997 is one of the main premises for the introducing of the control measure for the financial system – the Currency Board.*

But we should not forget also the fact that the Central Bank of whichever country, including BNB, is a part of the state apparatus. And in this sense the political independence of the institution is inside the country and in spite of the country.²² This means that independence from the government and the local bodies of the authority is not a lack of whatever relations and cooperation. On the contrary, the proper coordinating of the fiscal with the monetary instruments in the realization of certain short-term or long-term objectives is the best version for the macro policy in a certain country.

²¹ See *Minassian, G., M. Nenova, V. Iotsov*. The Currency Board in Bulgaria (The Beginning and Further). S., Gorex Press, 1998, p. 58.

²² Here we join the similar statement of *G. Piku* in his published article “Political Mechanisms: Interaction of the Monetary and Fiscal Policy with the Policy for Development of the Market of Securities”. – Financial Forum, 1997, N 7-8, p. 25.