

Is the Independence of the National Bank of Moldova in Danger?

Policy Recommendations to Enhance the Independence and Transparency of the Central Bank

ECONOMIC ANALYSIS AND FORECAST PAPER

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Contents:

Key Points	4
Introduction.....	6
Why Should the Central Banks Be Independent?	7
Assessment of NBM Independence	9
Conclusions and Policy Recommendations	20

Tables:

Table1. NBM independence score (based on the summary from Table 2)..	9
Table2. Diagnosis of NBM independence based on the legal framework..	10
Table3. Evaluation of transparency level in NBM activity	16

■ Key Points

Lately, the National Bank of Moldova (NBM), which sets and promotes the monetary and currency policy in the Republic of Moldova and has the overall objective to ensure and maintain the price stability, was subjected to repeated pressures from other Government institutions. Most of these actions aimed at facilitating the Government's and Parliament's indirect interference in the bank's decision-making process, defying the international good practices regarding the independence of central banks. The decision of the Constitutional Court dated 1 October 2013 was one of the recent attempts of this kind, which declared unconstitutional the provisions of the Law on NBM, according to which some acts of the NBM could not be suspended. Another recent initiative of the Government, which they subsequently gave up on, envisaged the draft Law Establishing the Financial Stability Committee, via which the Government would have been able to give direct orders to the NBM.

These actions risk to affect negatively the price stability and, respectively, economic growth and people's welfare, as they will undermine the efficiency of the monetary policy promoted by NBM. According to other countries' experience and international empirical evidence, the level of central bank's independence is correlated negatively to the inflation level and volatility. Hence, the more vulnerable the central banks are to political pressures, the weaker is the efficiency of monetary policies, with obvious adverse effects on the economy: erosion of people's purchasing power; disincentives for (long term) productive investment to the advantage of (short term) speculative investment; distortion of tax system and more expensive credits.

The NBM independence is estimated at an average of 0.64 of the maximum score of 1.00, the main gaps being found in institutional independence (0.45 of the maximum 1.00 points). The regulatory acts adopted by NBM are subject to a legal expert review procedure and are entered in the Register of Departmental Acts, held by the Ministry of Justice. Therefore following this procedure, the entry of NBM regulatory acts into force is conditioned by the results of the legal expert review and entry of NBM regulatory acts in the Register of Departmental Acts. The procedure can last too long, which undermines the capacity of the bank to respond promptly to certain risks in the banking system and, at the same time, exposes the central bank to potential pressures from political stakeholders. Another issue relates to the personal and financial independence, which scored 0.60 and, respectively, 0.63 out of maximum 1.00 points. The biggest issues worth mentioning are the following: NBM being obliged to approve its expenditure budget according to a regulation coordinated with the line Parliamentary Committee; NBM's obligation to transfer a share of the net profit to the state budget; lack of limitations for the NBM procuring state securities on the secondary market; Board members, except for the Governor, can be dismissed easily (by the simple majority of votes in the Parliament). A detailed analysis of these deficiencies is presented in Table 2.¹

A significant share of these deficiencies can be eliminated by passing some legal acts that are currently being reviewed by the Parliament, but their approval is delayed. This refers particularly to draft Laws No 487 and No 537 on Amendments and Addenda to the Law on National Bank of Moldova. According to them, the NBM will be able to approve independently its expenditure budget; the obligation to transfer 50% of the bank's profit to the state budget is annulled; the institutional and personal independence of NBM is envisaged more clearly; the obligation to consult the Government on establishing the exchange rate regime is excluded, and

¹Government Decision No 1104 of 28.11.1997 on the Legal Expert Review and State Registration of Departmental Regulatory Documents, point 6 and Annex 1 to the Decision, point 12

the corporate governance of the central bank is improved. At the same time, to avoid NBM acts being suspended for political interests, it was suggested to add a new provision in the Law on NBM, according to which an appeal can be filed within 30 days to the Bank's Board, by submitting a request in advance. Another important addendum to the draft law is that the requests to appeal the NBM acts shall be considered by the court only from the perspective of the approval procedure. The Parliament's delay in approving these provisions may reveal the political stakeholders' unwillingness to give up on some important leverages of pressuring the NBM.

Eliminating the gaps in the NBM independence is a critical precondition for ensuring long-term price stability. For that, the legal and institutional framework must establish clearer rules for the interaction of the central bank with other Government institutions. At the same time, it is necessary to eliminate the plenty of leverages that expose the NBM to the risk of potential political pressures. This relates to ensuring the autonomy of the institution in approving its expenditure budget; ensuring clear criteria for the cases when courts can suspend the NBM regulatory acts; eliminating the obligation to obtain the endorsement of Ministry of Justice for the NBM acts; specifying the interdictions for holding some high-ranking positions in public and private financial institutions for the members of central bank management bodies for some time before and after the mandate, as well as other measures meant to strengthen the NBM independence.

Strengthening of the NBM independence must be correlated with the increase in the transparency of its activity. The level of NBM transparency scored 0.70 out of the maximum 1.00 (Table 3). Some deviations from the international good practice have been found in this area. Thus, the minutes of Board meetings are published with a delay of 6 months; the surveys on inflationary expectations of the population and economic operators and the models used to forecast inflation are not published. At the same time, NBM could make better use of its resources and potential to enhance the research activity in various macroeconomic and macrofinancial areas.

Authorities should treat the issue of NBM independence and transparency in a holistic way, rather than solving only some of the identified flaws in an isolated manner. Even though the bank has a relatively high level of operating independence (score: 0.87 out of the maximum 1.00), this is undermined by the deficiencies in institutional, personal and financial independence. As a result, the entire decision-making process and the efficiency of NBM monetary policy are affected.

Strengthening the NBM independence is also relevant for the alignment to the relevant EU norms and practices. Thus, it is necessary to adjust the national regulatory framework to the principles of European Central Bank (ECB) functioning, Treaty on the Functioning of the European Union, and to the conclusions of ECB convergence reports. Eventually, the independence of central banks is a fundamental pillar of every market economy system at is a critical precondition for adherence to the EU.

■ Introduction

The National Bank of Moldova (NBM) is the main public institution responsible to maintain the stability of prices and of the banking system. Consequently, its importance is incontestable and its policies have direct impact on people's life quality and sustainable development of the country. The success in the achievement of the established objectives depends directly on the institutional, personal, operational and financial independence of the NBM. At the same time, the main principles of central banks independence are stipulated in the most important Community documents, such as the Treaty on the Functioning of the European Union or Protocol No 4 on the Statute of the European System of Central Banks and of the European Central Bank. Thus, any political interference in the decision-making process of central banks contradicts both the European norms and international good practices, while the risks of such interferences are imminent for people's welfare and country's development.

Recently a series of actions took place, which contradicted the mentioned principles and risk to affect the NBM independence. These also include the Constitutional Court Decision of 1 October 2013, stating that the exclusion of courts' competence to suspend the enforcement of NBM acts (except for the ones related to the withdrawal of bank license and bank liquidation) was non-constitutional. Another initiative is the draft Law Establishing the Financial Stability Committee that was subsequently excluded from the agenda of the Government, which institutionalized a mechanism for members of the Government to give orders to NBM. At the same time, when amending the Law on NBM, the Government intended to allocate one seat in the NBM Board to a member from the Government. In the same context, one of the deputy governors appointed in July had previously held high positions in the Government.²

These actions risk to undermine the independence of NBM and, consequently, to affect its capacity to ensure the stability of prices and of the country's banking system. At the same time, such initiatives alienate the national regulatory framework from the Community practices, contradicting the strategic vector of European integration followed by the Moldovan authorities.

This policy paper aims at identifying the main legislative and institutional deficiencies that affect or risk to affect the independence of NBM, as well as at providing a set of recommendations meant to improve the situation in this area. The paper is structured as follows: in the first part it argues why is it necessary to ensure the independence of central banks; in the second part it assesses the level of NBM independence and transparency; based on the identified issues, the paper ends with conclusions and recommendations meant to strengthen the independence and transparency of NBM.

²A. Lupușor (2013): „Intervenția pe marginea Proiectului de lege privind Comitetul Național pentru Stabilitatea Financiară”/”Intervention regarding the Draft Law on the National Committee for Financial Stability”, Expert-Grup,

■ Why Should the Central Banks Be Independent?

The skyrocketing inflation in the 1980s on the background of inefficient monetary policies determined the need to enhance the independence of central banks all over the world. This involved clear delimitation of monetary policy and tax policy and the exclusion of leverages by means of which Government and politicians could interfere with the decision-making process in the central banks. As a result, the efficiency and credibility of monetary policy have increased, while the price growth has stabilized.

According to empirical estimates, **the countries with a higher level of independence of central banks benefit of a greater stability of prices.** Thus, the less the public authorities interfere with the internal activities and decision-making of central banks, the greater is the efficiency of the banks in the achievement of their main goals. The effects of this policy are obvious. Price stability contributes to people's welfare and sets the necessary preconditions for a sustainable and inclusive economic development. As a result, currently the independence of the central bank became an indispensable element for the proper functioning of the market economy and for ensuring a non-inflationary economic growth.³⁴

There are three major arguments for ensuring the independence of central banks: (i) based on public choice theory and related to the personal and institutional independence; (ii) based on the relationship between tax and monetary authorities and envisages financial independence; and (iii) based on "prisoner's dilemma", which relates to operational independence. In all three cases, harming the independence of the central bank leads to a sub-optimal level of inflation and induces uncertainty in the economy.

According to public choice theory, central banks can be exposed to pressure from Government representatives to adjust the monetary policy to the objectives of the policy-makers. This involves the promotion of a low rates monetary policy, which has stimulative effects for the economy in the short run and, respectively, increases the budget revenue. At the same time, a relaxed monetary policy allows the Government to get loans under more favorable conditions on the local market. However, prolonging an extensive monetary policy generates imminent inflationary risks, with adverse effects for the economy in the long run.⁵

Divergences between Governments' fiscal generosity and central banks' monetary prudence become particularly acute in (pre)electoral periods, when the tax policy is used to maximize the electoral capital of the governing parties/coalition. Consequently, politicians, including the Government, tend to put pressure on central banks, for them to promote a more relaxed monetary policy in pre-electoral periods. In practice, pressures can relate to decreasing or keeping low monetary policy rates, depreciation of the national currency or injection of liquidities by procurement of state securities on the secondary market before elections.⁶

During the past years, it became clear that the ones responsible for monetary policy and the ones responsible for tax policy often speak different languages and can follow opposite interests. For instance, higher monetary policy interest rates undermine the possibilities of the

³ Crowe C., Meade E.E. (2008): „Central Bank Independence and Transparency: Evolution and Effectiveness”, IMF Working Papers, WP/08/119

⁴ The main impact of the inflation consists in: 1) erosion of the purchasing power and savings; 2) increased uncertainties and, respectively, lower investment activity; 3) higher nominal interest rates on loans; 4) distortion of the tax system.

⁵ Buchanan J. M., Wagner R. M. (1977): „Democracy and Deficit”, New York, Academic Press, 1977

⁶ Hyde S.D., O'Mahony A. (2010): „International Scrutiny and Pre-Electoral Fiscal Manipulations in Developing Countries”, The Journal of Politics, Vol. 72, ediția 03, pag: 690-704

Ministry of Finance to get loans at favorable rates and, as a result, hinders the promotion of an extensive budget policy. Hence, Governments are motivated to put pressure on central banks to fund the budget deficit at a minimum cost. Hence, if the legal and institutional frameworks do not guarantee a proper level of independence for central banks, the latter could give in to these pressures, which involves a strong and persistent inflationary effect.⁷

According to the third argument in favor of central bank independence, **politicians are tempted to trigger economic activity by influencing the central bank to create a shock, either by unexpected increase of money in circulation or by surprise-decrease of monetary policy rates.** However, these actions tend not to achieve the expected result due to sound expectations of economic operators, who can anticipate such a behavior of the central bank. Thus, the higher inflationary expectations lead to a sub-optimal level of inflation, which persists in time.

The most severe long term impact relates to undermining the credibility of monetary policy. The inability of central banks to cope with political pressures decreases the economic operators' trust in the monetary authority and affects significantly the efficiency of monetary policies. The erosion of trust in the central bank has a long term impact and can result in the bank losing the control over the inflation and exchange rate.

Therefore, there is a broad academic consensus on the need to ensure the independence of central banks. According to the best practice, this means several independence principles:⁸

- i. Personal independence - eliminate any possibility for politicians to put pressure on central banks by influencing the appointment or dismissal of the governor or Board members.
- ii. Institutional independence - central banks cannot take orders or instructions from other institutions (Parliament, Government, President, etc.) with respect to performing its tasks.
- iii. Operational independence - autonomy of central banks in formulating the policy objectives and selecting independently the necessary tools to reach the respective goals.
- iv. Financial independence - prohibiting the central bank to fund the public sector and other state-affiliated institutions and use of the budget approved by the Board.

The high level of independence must be counter-balanced by an increase in the transparency and responsibility of central banks, as well as by limiting their discretion level. The main criticism invoked against ensuring such a high level of independence for the central banks is that this creates a deficit of democracy: the population cannot control and influence the decision-making process of the central bank. As a result, the activity of these institutions tends to be made as transparent as possible and the discretion limits - to be stipulated as clear as possible.

⁷ Sargent T.J., Wallace N. (1981): „Some Unpleasant Monetarist Arithmetic”, Federal Reserve Bank of Minneapolis Quarterly Review, 5, pp. 1-17

⁸ Smaghi L.B. (2007): „Central Bank Independence: From Theory to Practice”, Conference „Good Governance and Effective Partnership”

■ Assessment of NBM Independence

The level of NBM independence is estimated at 64%: NBM⁹ independence score is 0.64 of the maximum 1.0. The biggest gaps are notices in the area of institutional independence (0.45 of 1.00), while NBM benefit of a quite high level of operational independence (0.87 of 1.0). Personal and financial independence are also troublesome (Table1)

Table1. NBM independence score (based on the summary from Table 2)

Types of independence	Score (maximum: 1.0)
Personal independence	0.60
Institutional independence	0.45
Operational independence	0.88
Financial independence	0.63
Total score:	0.64

Source: EXPERT-GRUP estimates

The legal framework that regulates NBM activity is not perfect and foresees several leverages that could be used by Government institutions to put pressure on the monetary authority. Though legislation has been improved over the past years, the central bank is still vulnerable to potential pressure from the Parliament or Government. Thus, most of the acts approved by NBM can be suspended by a court of law; the NBM regulatory acts are subject to expert review and entered in the Register of Departmental Acts, held by the Ministry of Justice; NBM regulatory acts entering into force is conditioned by the results of the expert review and registration of the acts into that Register (time-consuming procedures); there aren't any restrictions on past and future activity of Board members in Government institutions; NBM is obliged to transfer a share of its net profit to the state budget; NBM approves its budget based on a regulation coordinated with the relevant Parliamentary Committee; etc. A summary of these deviations from international best practice is shown in Table 2.¹⁰

⁹The methodology was based on a questionnaire with 20 questions (5 questions for each pillar of independence), which approach the independence principles of central banks. The methodology is based on the work of Cukierman A., Webb S.B. și Neyapti B. (1992): „Measuring the Independence of Central Banks and Its Effect on Policy Outcomes”, The World Bank Economic Review, Vol. 6, No. 3: p. 353 – 398, and the work of Crowe C., Meade E.E. (2008): „Central Bank Independence and Transparency: Evolution and Effectiveness”, IMF Working Papers, WP/08/119

¹⁰Law No 31 of 07.03.2013 annulled the possibility to suspend the NBM acts until final settlement of the case in the court in several important areas of its activity (see Article 11(4) of the Law on NBM amended by Law No 31). On 01.10.2013 the Constitutional Court (CC), at the request of a Cembery of Parliament, decided on the constitutionality of these amendments. CC decided that the NBM acts related to monetary and currency policy, including the safeguarding measures, acts on special administration of a bank and acts adopted during the evaluation and supervision of the quality of shareholders of the entities supervised by NBM can be suspended, until the final settlement of the case in the court. The act can be suspended at the request of a claimer or ex officio by the court. Such a CC decision is quite problematic, as it opens up a wide range of NBM areas of activity to complaints by any person or ex officio suspensions by the court, which could block the NBM activity for a long period of time. Though in its Decision of 15.11.2011 the CC justified in details the constitutionality of a bank's license withdrawal by the NBM rather by a court of law and maintained in the Decision of 01.10.2013 the legal provision on the exclusion of the possibility to suspend the NBM acts on license withdrawal or as part of the bank liquidation process, CC failed to explain the significant difference between these areas and the rest, for which it maintained the possibility to suspend the NBM acts. An example of an act issued by NBM in the monetary and currency policy area is the NBM act on the required reserves that commercial banks must keep or basic interest rates for the loans extended to commercial banks by NBM. It is difficult to understand how the access to justice will be violated for a person who appealed the respective act, if the final court decision is obtained in 3 months, without having the possibility to suspend it. It is very unlikely for such acts to be appealed at all or their suspension to be requested. But, it is very likely that the NBM acts related to the quality of shareholders to be appealed and a suspension by the court to be requested. Another problematic issue relates in general to the possibility of suspending the NBM acts. The NBM are applicable to plenty of people, and if they are appealed in the court and suspended, then by meeting the request of some people, the possibility of other people to apply the appealed act will be suspended, as well. It seems that the balanced between the general and individual interest is not maintained in this case. Last but not least, it is not clear why it is necessary to have the possibility to suspend NBM acts in terms of the purpose. Suspension of a NBM act is a precautionary measure. Precautionary measures are applied by a judge only in circumstances that justify such measures, with the purpose to make sure that the enforcement of the decision is ensured. In the case of

Table 2. Diagnosis of NBM independence based on the legal framework

INDICATOR	CODE	SCORE	COMMENT
<i>Personal independence (0.6 of 1.0)</i>			
Who appoints the Governor?		0.5	The Governor of the National Bank is appointed by the Parliament, at the proposal of the Parliament Speaker (Article 23(2) of the Law on NBM)
Board	1		
A council formed of representatives of NBM, Government and Parliament -	0.75		
Parliament	0.5		
Government	0.25		
One or several members of the Government	0.00		
For how long is the Governor appointed?		0.75	The Board members are appointed for 7 years (Article 23(6) of the Law on NBM)
Over 8 years	1.00		
6-8 years	0.75		
5 years	0.50		
4 years	0.25		
Under 4 years	0.00		
How is the Governor dismissed?		0.83	The Governor and other Board members are dismissed at the proposal of the Parliament Speaker (Article 27(1) of the Law on NBM) However dismissal is conditioned by a series of infringements that are not related to the policy implemented by NBM.
No conditions for dismissal are stipulated	1.00		
Only for the ones that are not related to the policy followed by NBM	0.83		
At the discretion of the Board	0.67		
At the discretion of the Parliament	0.50		

NBM, this institution will always exist and could be obliged to enforce the court decision, therefore it is not clear why the impossibility to suspend a NBM act would violate a person's right to justice. As a conclusion, it seems that the CC decision allows suspending the NBM acts, which could affect its activity. In such circumstances the case law becomes very important. Judges should examine very carefully and in detail all requests to suspend an NBM act.

Unconditioned dismissal, possible at the discretion of the Parliament	0.33		
At the discretion of the Government	0.17		
Unconditioned dismissal, possible at the discretion of the Government	0.00		
With how many votes are the Governor and Board members dismissed?		0.67	The Governor is dismissed by the Parliament with the vote of 2/3 of the total number of MPs. The Board members are dismissed by the Parliament, with the simple majority of votes (50%+1) of the total number of MPs (Article 27(3) of the Law on NBM).
With constitutional majority (2/3 or 3/5 of the votes) both the Governor and Board members.	1.00		
The Governor - by constitutional majority and the Board members - by simple majority (50%+1)	0.67		
They are all dismissed by simple majority of votes.	0.33		
They are all dismissed on the proposal of the Parliament Speaker.	0.00		
Does the Governor have the right to have held any other public positions in the past or to hold them in the future?		0.25	The Law on NBM prohibits the Board members, during their mandate, to be affiliated to social-political parties or formations; to conduct political activities or to participate in such; to make electoral agitation for a party or social-political formation (Article 23, (6^1). However, the legislation does not stipulate any restrictions on holding other public functions, both in the past and in the future.
No	1.00		
Only with the permission of the Government	0.50		
Lack of legal provisions	0.00		
<i>Institutional independence (0.45 of 1.0)</i>			
Are there members of the Government or Parliament part of the NBM management?		1.00	The Board membership does not include any members of Government, Parliament or other public institutions

No	1.00		
Yes	0.00		
Does the legislation envisage any restrictions on the previous professional activity in the Government for Board members?		0.00	The legislation does not foresee any restriction in this respect. One of the Board members has held previously the position of deputy Minister of Finance.
Yes	1.00		
No	0.00		
Is it necessary for the NBM acts to be endorsed by other public institutions?		0.50	The legislative acts issued by NBM, before coming into force, need to be endorsed by the Ministry of Justice. Still, the endorsement relates to observing specific rules for legal papers and does not involve and expert review of the content and essence of these acts.
No	1.00		
Yes, to check the procedure, not the content.	0.50		
Yes	0.00		
Do the acts issued by NBM come into effect immediately after approval or after procedures that cannot be influenced by the bank?		0.50	The regulatory acts adopted by NBM are subject to a legal expert review procedure and are entered in the Register of Departmental Acts, held by the Ministry of Justice, procedure which impacts the entry into force of the regulatory act issued by NBM. As per the current regulations, this procedure does not equal an endorsement of a regulatory act, but a review of the regulatory acts adopted by the NBM. This interference with adoption of NBM final decisions undermines the independence of NBM and obstructs it from performing its legal tasks. ¹¹
Come into force immediately after approval	1.00		
Only some acts come into force immediately after approval	0.50		
No acts come into force immediately after approval	0.00		

¹¹Government Decision No 1104 of 28.11.1997 on the Legal Expert Review and State Registration of Departmental Regulatory Acts, point 6 and Annex 1, point 12

Can the acts issued by the National Bank be suspended?		0.25	As a result of the Constitutional Court Decision of 1 October 2013, the acts of the National Bank, except for the provisions on withdrawal of bank license and on bank liquidation, can be suspended until the final settlement of the case by the court, at the request of a claimer or ex officio by the court.
No	1.00		
Can be suspended, but partially	0.50		
Yes	0.00		
Operational independence (0.88 out of maximum 1.0)			
Who sets the inflation level targeted by NBM?		1.00	Current target of 5% (+/- 1.5 p.p.) was established by NBM.
The bank on its own.	1.00		
The bank together with Government and other state authorities.	0.50		
The Government or other state authorities.	0.00		
Who makes monetary policy decisions?		1.00	The National Bank establishes and implements monetary and currency policies in the country (Article 5(1) of the Law on NBM)
The bank on its own.	1.00		
The bank, but it has limited influence.	0.67		
The bank just consults the Government.	0.33		
The bank has no influence.	0.00		

What is the goal of NBM?	0.75	The fundamental goal of NBM is to ensure and maintain prices stability. Without prejudice to its fundamental goal , the National Bank promotes and maintains a financial system based on market principles and supports the general economic policy of the country (Article 4 of the Law on NBM). The problem is that it is difficult to determine when supporting the economic policy of the country does not "prejudice its fundamental goal".
Price stability is the only objective	1.00	
Price stability is the main objective, other secondary objectives are also stipulated (stability of the banking system, economic growth, etc.)	0.75	
Price stability is one of the bank objectives, while the others are maximizing employment or economic growth	0.50	
Lack of specifications on the objective of the central bank	0.25	
The established objectives do not include ensuring price stability	0.00	
Is the NBM obliged to consult the Government when performing its tasks?	0.67	NBM establishes, by consultations with the Government , the regime of national currency exchange rate (Article 5(1) h) of the Law on NBM). At the same time, according to Article 6(4) "the National Bank shall be independent in performing its tasks set by this law and shall not ask for or receive instructions from public authorities or any other authority"
No	1.00	
It must, but without getting instructions from the Government	0.67	
It must, only in some areas	0.33	
It must consult permanently the Government	0.00	
Are there any restrictions in the selection of monetary policy tools available to the NBM?	1.00	NBM is independent in terms of selecting the monetary policy tools and there are no restrictions coming from other institutions in this respect.

No	1.00		
In some cases, these need to be approved by the Government or by the Parliament	0.50		
Yes, these need to be approved by the Government or by the Parliament	0.00		
Financial independence (0.63 of 1.0)			
Is it prohibited for the NBM to buy or sell state securities on the primary market?		1.00	According to Article 41 of the Law on NBM, "the National Bank shall not provide loans and guarantees under any form to the state or its bodies, including by buying state securities on the primary market".
Yes	1.00		
No	0.00		
Is it prohibited for the NBM to buy or sell state securities on the secondary market?		0.00	No provision can prohibit the National Bank to buy and sell state securities, given that the National Bank buys only by open market operations securities that were issued publicly. As a result, NBM could be forced to buy state securities on the secondary market, which could raise the demand for state securities issued on the primary market and, respectively, could let the Ministry of Finance to get loans at more favorable rates.
Yes	1.00		
No	0.00		
Are the advanced transfers from NBM to the Government prohibited?		1.00	No transaction or operation performed by the National Bank shall result in providing financial support to the state authorities (Article 37(1) of the Law on NBM).
Yes	1.00		
No	0.00		
Is NBM independent in approving the expenditure budget?		0.67	All expenses of the National Bank are included in the budget approved by the Board according to a regulation coordinated with the Parliamentary Committee on Budget and Finance (Article 21(1) of the Law on NBM).

Yes	1.00		
The budget must be coordinated with the Parliament	0.67		
The budget must be coordinated with the Government	0.33		
The budget is approved by Parliament or Government	0.00		
Does the net profit of NBM remain under the management of the bank or is it transferred to the state budget?		0.50	According to the Law on NBM, at the end of the financial year, 50 per cent of the profit available for distribution shall be allocated to increase the authorized capital. At the same time, the remaining profit available for distribution shall be transferred to the state budget within 15 days from the receipt of the external auditor's report on the financial statements of the National Bank (Article 20 (5) and (6) of the Law on NBM).
Stays integrally with the Bank	1.00		
A part remains under the management of the bank and a part is transferred to the state budget	0.50		
Is totally transferred to the state budget	0.00		

Source: EXPERT-GRUP analysis

The gaps related to independence of NBM are combined with some deviations from best practice regarding transparency in the activity of the bank. According to the estimates, the transparency level scores at 0.85 of the maximum 1.00 (Table3). Though some progress is noticed in terms of raising the transparency of the institution (publishing quarterly inflation reports, explanation of monetary policy decisions, practicing public consultations, etc.), there are still deficiencies in this area. Thus, the minutes of Board meetings are published with a delay of 6 months; the surveys on inflationary expectations of the population and economic operators and the models used to forecast inflation are not published. At the same time, it is worth mentioning that NBM publishes a relatively small number of analytical, research and economic forecast products.

Table3. Evaluation of transparency level in NBM activity¹²

INDICATOR	CODE	SCORE	COMMENT
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¹²The methodology is based on a questionnaire consisting of 10 questions that approach the main aspects of central bank transparency. The methodology is based on the work of Crowe C., Meade E.E. (2008): „Central Bank Independence and Transparency: Evolution and Effectiveness”, IMF Working Papers, WP/08/119

Is there any legal provision on the objective of the NBM?		1.00	The Law on NBM stipulates that "the fundamental goal of NBM is to ensure and maintain price stability" (Article 4 (1)).
Price stability objective is stipulated	1.00		
Several contradictory objectives are stipulated	0.50		
NBM objectives are not mentioned	0.00		
Is there any explicit numerical target related to inflation level?		1.00	The medium-term inflation target aimed by NBM is 5% (+/- 1.5 p.p.).
Yes	1.00		
No	0.00		
Does the NBM publish the result of surveys that would allow estimating the inflationary expectations?		0.00	No such surveys are published.
Yes	1.00		
No	0.00		
Does NBM publish any economic forecast papers?		1.00	The report on inflation published quarterly by the NBM contains such analyses. At the same time, one can download from NBM website the file with data about CPI for short and medium term.
Yes, analyses and figures	1.00		
Yes, analyses or figures	0.50		
Does not publish	0.00		
Does the NBM publish the minutes of the Board meetings?		0.50	Starting with Inflation Report no. 3 of August 2013, the NBM publishes the result of Board meetings, with a 6-month delay.
Yes	1.00		
No	0.00		
Does the NBM publish the voting results of Board members during the meetings?		0.50	As of 1 January 2013, the monthly press releases on the day of passing decisions about monetary policy include the voting results, but they specify the votes by each particular Board member.
Yes	1.00		
No	0.00		

Does the NBM publish the monetary policy decisions?		1.00	Every month NBM publishes a short analysis of the monetary policy decisions approved during the Board meetings, as well as their substantiation.
Yes	1.00		
No	0.00		
Does the NBM publish any analyses regarding the risks that can affect the forecasts?		1.00	The report on inflation published quarterly by the NBM contains such analyses.
Yes	1.00		
No	0.00		
Does the NBM publish analyses comparing the previous forecasts with the current trends?		1.00	The report on inflation published quarterly by the NBM contains such analyses.
Yes	1.00		
No	0.00		
Does the NBM put up for public consultations the draft regulatory acts?		1.00	The regulatory acts are proposed for public consultations. All the information can be found on NBM website.
Yes	1.00		
No	0.00		

Source: EXPERT-GRUP analysis

NBM launched some legislative initiatives meant to eliminate many of the aforementioned deficiencies, but their approval by the Parliament is delayed. Thus, a series of amendments and addenda to the Law on the National Bank of Moldova come to strengthen the independence of the central bank by excluding the obligation to consult the Government related to the establishment of exchange rate regime, to transfer of 50% of the bank's profit to the state budget; it provides autonomy to the bank with respect to approving the budget of the institution, as well as ensures the possibility for Board members to appeal in court the potential decision of the Parliament to dismiss them.

At the same time, the Parliament is examining a draft law which sets conditions under which the NBM acts can be appealed in the court and, in this way, it limits the possibility of political stakeholders to put pressure on the bank. Particularly, it is proposed that the suspension of NBM acts enforcement can be requested in court only after these acts are appealed in the NBM Board, within 30 days from the decision of the Administration Board on this request or in case of failure to solve in due time the request submitted in advance. At the same time, several conditions are established when NBM acts can be suspended, namely: a) the reasons invoked by the claimer supporting the main action are pertinent and well substantiated and whether enough evidence was submitted to support the case; b) the claimer can prove that the circumstances of the litigation need an urgent decision to suspend the appealed administrative act, in order to avoid severe and irreparable damage to the interests of the claimer; c) the damage that could be caused to them exceeds the public interest followed by the issuance of the appealed administrative act.

As a result of passing these amendments and addenda, the NBM independence score will increase from 0.64 to 0.80 of the maximum 1.00. The financial independence (from 0.63 to 0.80) and the institutional independence (from 0.45 to 0.60) will grow the most. At the same time, the operational independence will meet in full the international best practices, scored with 0.95 of the maximum 1.00.

■ Conclusions and Policy Recommendations

Politicians are often motivated to put pressure on central banks in order to make them support economic growth at the cost of price instability. The reason is that often the objectives of central banks to maintain price stability tend to contradict, in the short run, the Governments' objectives of economic growth. Thus, in order to maximize their electoral chances, the politicians put pressure on the central banks to promote more relaxed monetary policies, particularly before elections. If central banks are vulnerable to such pressures and enter the politicians' game, they can lose control over the inflation, with adverse and long-lasting effects on the economy.

Independence of central banks is a basic condition for ensuring a non-inflationary economic growth and a fundamental pillar for a market economy system. This is confirmed by the indirect relation, proved empirically at the international level, between the level of central bank independence and volatility of inflation in the respective countries. Thus, the more the monetary authorities are exposed to political pressure, the higher the inflation level is, which induces adverse effects for the economy: erosion of purchasing power of population; disincentives to the productive investment to the advantage of speculative investment; distortion of taxation system and credits becoming nominally more expensive.

The diagnosis of the Moldovan legal framework identified a series of gaps that allow state authorities to intervene in the NBM activity.

- i. *Institutional independence* is most vulnerable, being evaluated with 0.45 out of maximum 1.00. Particularly, the legislation does not envisage any restrictions on the previous professional activity in high positions in public and private financial institutions in the financial sector for Board members; the regulatory acts are subject to legal expert review and are entered in the Register of departmental acts, held by the Ministry of Justice, so that NBM regulatory acts enactment depends on the results of the legal expert review; and most of acts issued by NBM can be suspended if a court is notified.
- ii. *Personal independence* is relatively weak as well, getting the score 0.60 of the maximum 1.00. Particularly, the Board members, except for the Governor, can be dismissed relatively easily (by simple majority vote in the Parliament),
- iii. The *financial independence* level is estimated at 0.63 of the maximum 1.0. The biggest issues relate to the fact that NBM must to coordinate the regulation on the expenditure budget with the line parliamentary committee, a share of the annual net profit must be transferred into the state budget and the legislation does not foresee any restrictions for NBM on buying or selling state securities on the secondary market.
- iv. The strength of NBM independence is its *operational independence*, being evaluated with 0.87 of the maximum 1.0. However, some deviations from the international good practice have been found in this area, too. Thus, NBM establishes, by consultation with the Government, the exchange rate regime of the national currency, while NBM legislation allows NBM to support the economic growth objective followed by the Government, given the very vague condition "with no harm to its fundamental goal".

Though most of these leverages have not been used very often by Government or Parliament against NBM, their existence as such can intimidate the monetary authority and generates the risk of them being used in the future. Consequently, the identified gaps need to

be removed in order to let the National Bank perform its tasks in an objective and efficient way and to ensure the stability of prices and of the banking system.

Recommendations to Enhance the Independence and Transparency of NBM

The four pillars of the central bank independence should be perceived as an integral system and the authorities should not approach the identified problems as isolated. The reason is that every gap that undermines at least one of the independence pillars tends to affect automatically the other pillars, since they are inter-connected. For instance, the weaknesses related to institutional independence also undermine the operational activity of NBM, despite the fact that, viewed separately, the bank benefits of a high level of operational independence. The main recommendations are as follows:

- **The conditions for the dismissal of the Governor should be similar to the conditions for other Board members.** In this respect, all Board members must be dismissed only with the vote of 2/3 MPs.
 - **Goal:** To ensure a higher immunity for all members of the NBM management to potential political pressure by using the instrument of dismissal.
- **The legislation should stipulate explicitly that the Governor and other Board members are prohibited to hold positions of accountability in public and private financial institutions** for at least 5 years before taking over the mandate and at least 5 years after leaving the position.
 - **Goal:** To diminish the risk of corrupting Board members by political stakeholders with the promise to get in the future an important position in the Government. At the same time, to ensure that the NBM management does not have any links with the Government or Parliament due to some previous activity.
- **All NBM acts, if needed, should be enacted immediately after their approval and the obligation to have a legal expert review and to be registered with the Ministry of Justice needs to be canceled.** The main condition is to post immediately the acts on the website of the institution and, further, to publish them in the Official Gazette. Currently the procedure of enactment of NBM regulatory acts can take too much time (several months), which can undermine the promptness with which the institution should respond in order to maintain the stability of the banking sector.
 - **Goal:** To ensure quicker work of the monetary authority in the elimination of potential risks that could destabilize the situation in the banking sector. At the same time, elimination of indirect leverages by means of which Government institutions can put pressure on NBM, hampering the enactment of various acts of the bank.
- **Suspension of NBM acts must be applied in exceptional and very well-substantiated situations, in order to exclude the possibility to use this tool for political or individual interests of some people.** The draft Law no. 487, which is now in the Parliament for review, brings improvements that diminish the risks related to the possibility to suspend most of NBM acts. Particularly, the draft foresees the possibility to appeal the NBM acts only in terms of procedure, after the review by the Board and stipulates a set of conditions under which an NBM act can be suspended. The Supreme Court of Justice could also issue a recommendation or an explanatory decision, by which would explain the specific nature of NBM acts and the strict conditions under which a suspension of bank's acts would be allowed. As well, the competent authorities could monitor the enforcement of NBM acts suspension by courts and could come with further legislative proposals, should the practice prove an abuse in the application of this mechanism.

- **Goal:** To eliminate a potential leverage by which political stakeholders or individuals could actually block the activity of NBM by involving it into several lawsuits at the same time.
- **The possibility of NBM to support the Government's economic policies must be conditioned by a set of very clear criteria.** For instance, the bank could support the Government's economic growth objective only when the inflation forecast for the next 24 months is under the pre-established target.
 - **Goal:** To eliminate the legislative ambiguity associated to the expression "with no prejudice to its fundamental goal" and, respectively, to diminish the NBM discretion margin in the promotion of monetary policy.
- **Eliminating the obligation to consult the Government on the currency policy.** In this regard, it is necessary to exclude Article 5(1) from the Law on NBM, according to which NBM establishes, by consulting the Government, the regime of national currency exchange rate.
 - **Goal:** To exclude possibilities for the Government to put pressure on the currency policy, particularly by determining the bank to depreciate the national currency in order to raise the budget collections, consumption, exports, and economic growth.
- **Prohibition of indirect NBM funding for the budget deficit.** In this respect, it is necessary to prohibit to the central bank procurement of state securities on the secondary market.
 - **Goal:** To eliminate the possibility by which political stakeholders can force the central bank to procure actively state securities on the secondary market, injecting liquidities into the banking system and raising the banks' demand for securities on the primary market.
- **Ensuring the full autonomy of NBM in the development and approval of its budget.** For this it is necessary to eliminate the provision from Article 21(1) from the Law on NBM, according to which the bank's budget needs to be approved based on a regulation coordinated with the Parliamentary Committee for Budget and Finance.
 - **Goal:** To eliminate the possibility for political stakeholder to intervene in the organization and internal policies of NBM by influencing the structure of bank's budget. To provide autonomy to the bank, for it to make the needed restructuring in order to raise the efficiency of internal functioning of the institution.
- **Directing the entire net profit of the NBM to development and modernization of the institution.** In this regard, it is necessary to amend Article 20(6) of the Law on NBM, according to which the balance of the profit available for distribution shall be transferred to the revenues of the state budget.
 - **Goal:** To exclude the motivation of the Government to put pressure on NBM to minimize the costs and maximize the revenues from its operational activity.

Improvement of NBM independence must be associated with an increase in its transparency and limitation of the bank's margin of discretion. Hence, the following actions are needed:

- To publish the results of surveys or other sources of data that would allow an estimation of inflationary expectations.
- To publish the specification of models used by the bank to forecast inflation.
- To communicate more actively with the public about the activity of NBM and monetary policy objectives.

- To strengthen the research activity within NBM focused on building economic analysis and forecast instruments, as well as in the area of identification and mitigation of macroeconomic and macro financial risks.
- To publish all NBM regulatory acts on its website, ensuring the possibility to search through them by date and content.