

DR. KOVÁCSNÉ DR. SIPOS ÁGNES

**THE INVESTIGATION OF HISTORICAL DEVELOPMENT OF
CENTRAL BANK INDEPENDENCE SINCE THE 18TH CENTURY**

A COMPARATIVE STUDY OF EASTERN AND WESTERN EUROPEAN WAYS OF
DEVELOPMENT THROUGH NINE MEMBER STATES OF THE EUROPEAN UNION

Theses of PhD dissertation

Miskolc

2007.

I. Summary of research task and the aims of my research

The investigation of central bank independence belongs to the interdisciplinary research areas, there are many papers dealing with this topic also in the field of jurisprudence and economics too. The jurisprudential literature discusses central bank independence in connection with the European System of Central Banks and more punctual it is considered parallel with the Maastricht Convergence Criteria, when investigating the ability of member states to enter the third period of EMU.

In the definitions of central bank independence the followings are mentioned as key elements: the autonomous functioning of central banks from government and other external influences, determining the monetary policy alone. The legal positioning of central bank independence has dual directions: (i.) ensuring the uninfluenced functioning of central bank; (ii.) protecting the general interests of economy. Economic mechanisms are typically reflected by financial law. Central bank laws are excellent examples for this reflection, as the more precise recognitions of economic mechanisms lead to modifications in legal texts.

The legal system of the European Union delegates the legal regulation of central bank independence into national legal systems with some legal restrictions fixed in the levels of primary and secondary sources of law. The regulatory model of EU legislation declares general principles which are subject to be incorporated and completed by national legal regulations.

The aim of my PhD dissertation is the investigation of central bank independence but not in the context which is usually accepted or even criticised in the literature. My dissertation does not involve investigations between the level of central bank independence and certain macroeconomic factors, since in this latter case more detailed macroeconomic calculations would be required, which cannot be included into a PhD in law sciences.

In my dissertation the development tendencies of central bank autonomy are observed based on five historical periods of 9 banks in ESCB.

Including all 27 central banks in ESCB and observing more than five periods would significantly exceed the frames of a PhD dissertation, therefore I had to limit my sample in order to collect an even treatable mass of data by taking special care not to harm the original aims of research. Central banks in my sample were selected intentionally to well represent the EU member states in historical, economic and geographical points of view.

The aims of my research can be identified as follows:

1. The comparison and detailed discussion of commonly used models measuring central bank independence and the presentation of main critics in the literature related to these models.
2. The exploration of historical tendencies and connections in the regulations of central bank independence from the aspect of comparative law.
3. The development of an own model – by taking into account the theories about defining and measuring central bank independence – which is completely based on legal background and able to measure the level of independence in legal texts created in different historical periods and political environments.

4. The differentiation between Eastern and Western European ways of development and the identification of their peculiarities.
5. The observation of the convergence of legal methods regulating central bank independence over historical periods of time by applying my own research model and analysing statistical data.

In the first chapter I give an overview about the concept of central bank independence involving the economic and legal definitions of central bank. This chapter also deals with the main development ways of central banks (i.e. the British, French, Prussian-German and Swedish) focusing on the historical formation of independence. Significant part of this chapter pays attention to present the Hungarian development in details.

Next chapter contains the different methods of measuring the level of central bank independence. In this chapter my ambition was to collect and present the most widely accepted researches in this field together with their theoretical backgrounds.

Third chapter treats with three main issues. At first I introduce my own research model which is used to observe the development of European central bank independence. After that my research results are presented: the differences between Eastern and Western European ways of development are analysed mainly from a legal point of view which are many times supported by statistical calculations. As part of this second main issue, an analytical presentation of CBI is provided in case of all the observed central banks. At the end of this chapter the convergence of legal methods regulating central bank independence over historical periods of time is analysed in all three fields (i.e. personal, organisational and financial) of CBI.

Fourth chapter concludes my results and findings with the aim of providing a brief overview of historical development in legal regulations about central bank independence since the very beginning roots of Sveriges Riksbank until the establishment of ECB.

The annex of my dissertation (cca. 150 pages) contains the tables with detailed analyse of national legal regulations in all the time periods and in case of all the observed central banks.

II. The methods and sources of the research

I have tried to give primary importance to the comparison of legal models of the examined member states in my dissertation. In this process the historic, dogmatic and comparative legal analysis of legal rules and the mapping up of connections between similar elements had determining role. From the very beginning of my research I took an interest in central bank independence, but first I was dealing with the European legal methods in force and later I had my interest changed: it made a turn to the essential aspects of the development tendencies of central bank independence.

The fundamental bases of my research can be dated back to the year 2000, when I examined the connections between the Hungarian bank-law and the requirements of the European Union. I specified the direction of my research to examine in which degree the bank-law of candidate countries comply with the EU requirements. Later I had my interest changed: it made a turn to the essential historical aspects of the legal rules in force.

My research was mainly a historical one, I analysed the ancient legal texts with the parallel examination of legal environments of the given age. The main sources of my research were bygone legal texts (royal decrees, acts, and enclosed documents), and the documents of the pass (documents about the process of bill-passing, legal proposals, attached interpretations).

Collecting these ancient legal texts and documents was not easy at all, partly I used the documents of the library of the Hungarian National Bank. Since only few documents were available I got in touch with the relevant European central banks, and as the result of these requests I managed to collect the relevant documents in two years. The translation and the interpretation of these texts also needed significant time and work, the results are my tables which can be seen in my dissertation and in the appendix.

Two central banks provided me opportunity to do some research at their special library, and to consult with central bank experts. In July 2004 I spent 2 weeks at the Latvijas Banka, when I was succeeded in collecting many documents and information for my dissertation, while in January 2006 the Sveriges Riksbank provided the background of my research for one week.

On the occasion of my foreign study-trips I gathered from the libraries of Université Louis Pasteur, Strasbourg and Université de Montpellier jurisprudential papers and collected works dealing with the development of central banks, which were mainly written in English and Spanish.

Many studies dealing with this topic restrict the examination to the exploration of connections between economic factors, or contrary to the jurisprudential aspects of central bank independence and even some papers investigate the topic only on historical basis. According to my intention – taking into consideration that my dissertation should have mainly legal characteristics – one of my research methods was the analysis of legal sources, which was complemented many times with some quantitative analytical methods, as my dissertation shows many interdisciplinary characteristics.

So, one of the main methods of my research is the *analysis of legal texts*, which is fundamentally determined by the *comparative approach* of the dissertation. I take special emphasis on the investigation of those legal solutions and inferences which can be parallel found in different models of regulation or have similar theoretical background. During this research my intention was to map up the main streams and connections of European dogmatic reasoning and legal practice in order to find relations with the Hungarian regulations.

The other, complementary method of my research was the time-series and cross-sectional *statistical analyse* to quantitatively support my observations and findings about legal tendencies.

Thus, my research was carried out with more methods by taking care of the strict requirements of law sciences but in the same time I also emphasised the economic connections and reasons as well as the historical backgrounds of a certain period of time.

My dissertation refers to 70 legal texts of the observed 9 countries, 180 scientific studies or papers and 13 sources which can be found only in electronic version on the Internet.

III. The results and expected benefits of my research

Based on the theories of the most relevant authors in the scientific literature and the processed legal documents I sum up my theses – which were discussed in details in my dissertation – in the following:

1. The principle of central bank independence appeared only in the early 1970s and researches in this field also began in this period. However – as it was observed during the analysis of legal documents from the 18th and 19th centuries – the origins of guarantees of central bank independence were present in legal documents at the time of establishment of European central banks' predecessor institutes.

One of the most important characteristics of the European central bank development in the 18th and 19th centuries is that not only one bank has the sole right of issuing banknotes in the territory of a state. This is the time of establishment of those banks which already had some characteristics of so-called modern central banks, but the functions of a commercial and a central bank are not separated at all. These banks receive privileges from the monarchs (e.g. the right of bringing in existence a branch) in return for financing the debt of the state which highly decreases the level of financial independence. Either nomination of governors and vice-governors or the activities of the bank depended mostly on the will of the monarch and this way personal independence was also decreased.

Recording the guarantees of central bank independence in legal documents and the application of these rules in practice was justified by the needs for economic and financial stability in the 18th and 19th centuries. Intolerable and uncontrollable economic situation can be caused if more than one bank owns the right of issuing banknotes, especially in the case if the notes of the other bank are not accepted reciprocally. That is the reason why the monopoly right of issuing banknotes and the central position of national bank is especially important.

2. Studies – using various scientific methods, like law-sociology, law-history and macroeconomics – in the field of central bank independence try to find connections between different economic factors and the level of independence. Based upon the methods and goals of research studies can be divided in the following three categories:

- Papers in the first group measure central banks' *de iure* independence and test whether there is a correlation between inflation and independence.
- Studies in the second category test the correlation of independence and other economic factors beside or ahead of inflation. Furthermore, different elasticity tests are used to answer questions like as follows: (i.) In case of a more opened economy will the correlation between independence and inflation be stronger or weaker? (ii.) What is the effect of a unit move on the scale of independence on certain economic factors, like inflation, per capita GDP or unemployment, etc.?
- The main goal of papers in the third group – which analyse mainly developing or transition countries – is to compare the legal rules of these countries to documents which are considered as etalon (e.g. the Statute of ECB or the Bundesbank Act) in order to determine the way of legal development in the future.

3. There is no unified definition as well as measuring method for central bank independence in the literature. The most important differences in these methods are in the analysed countries, period of time, the use of questions and their weights. Among others, this subjectivity is the reason why several critics have appeared in this field of subject. The critics about CBI theories in the scientific literature can be divided into the following two groups:

- several authors argue that ensuring central bank independence is not enough to reach a low level of inflation;
- others criticise the reliability and usefulness of CBI indexes because of the subjective composition, i.e. all CBI measuring models show differences in several points.

Based on some statistical tests which were carried out in my dissertation it can be justified that even in case of huge differences in measuring methods (e.g. number of questions, scale of evaluation, use of weights, etc.) the results of these researches – concerning especially the order of central banks' independence – are quite similar. Those factors which cause the differences between these methods have no significant influence on identifying which banks have high or low level of independence.

4. Two main types of development of central bank independence can be identified from a historical point of view: Eastern-European and Western-European ways of development which have different peculiarities.

The main characteristics of the Eastern-European way are the followings:

- establishment of Eastern-European central banks in the 20th century is dilatory compared to Western-European way
- the usual form is joint-stock company with significant participation of foreign and private capital and the dominance of state capital is not typical
- the establishing legal documents are based on Western-European patterns, but in many cases they guarantee even higher level of independence for central banks
- after WWII strict legal bounds came into force (by politics, government and foreign power), central bank independence has almost totally disappeared, this is the period of 'dependency'
- just after the change of regime the level of independence have risen dramatically to an outstanding level
- at the time of EU accession or even 2-3 years before legislation has followed Western-European patterns again to ensure high level of independence

The main characteristics of the Western-European way are the followings:

- Western-European central banks were established in the 19th century or even before
- the usual form is joint-stock company with significant participation of foreign and private capital and the dominance of state capital is not typical
- the level of central bank independence decreased somewhat between the two world wars
- after WWII a smooth development can be observed in case of all central banks
- since WWII the independence of Deutsche Bundesbank surpassed all of the others, but after the 1990s all the others closed up and showed similar level of independence

According to my results the Western European way of development consists of four main models – the British, German, French and Swedish ways – which show up many peculiarities at the field of CBI. These models were applied by other European countries establishing their own central banks.

5. The Act V of 1924 establishing the Hungarian Central Bank fulfilled all requirements of the general development level of that age. It can be appreciated as a legal document which implied and further developed the achievements of Western-European legislation, providing an even higher level of central bank independence. A high level of independence can be observed in the Act V of 1924 on the Hungarian National Bank, which finding is based on the followings. On one hand, the demand for an independent national bank became more and more urgent – which followed from the rising of national identity – since the Conciliation in 1867. On the other hand, the establishment of an independent national bank was a key condition of the loan from the United Nations. British and Austrian patterns can be observed in the Act V of 1924 on the Hungarian National Bank and what is more, many principles of CBI were included to regulate the connections between the government and the newly established bank.

6. The Act LX of 1991 was created on the basis of the Act of 1924 completed with many legal instruments from the Bundesbank Act of 1957 to raise the level of independence.

The Act of 1991 surpassed the Act of 1924 in level of independence which is mainly due to the economic development of the passed cca. 70 years and to the following of Western-European patterns, but the legal solutions of it were quite similar to the previous one.

Observing only the level of personal independence in the case of Hungarian Central Bank we find that the level of independence reached by the Act of 1924 was slightly higher than by the Act of 1991. This is mainly due to the fact that the Act of 1924 contained professional requirements for the executive officers while the Act of 1991 contained no such requirements. An other cause of the difference is that prescribing a task or duty for the bank was allowed only by act according to the Act of 1924 while it was allowed also by governmental act in the text of the Act of 1991.

7. The organisational independence of Deutsche Bundesbank is outstanding since its establishment in 1957 – this is the third period in my model – and was considered as etalon for the newly established central banks in Eastern-Europe. It is worth to note how high level of organisational independence was provided by the Latvian Acts of 1992 and of 2002 as well as the Czechoslovakian Act of 1992 and the Czech and Slovakian Acts of 1992 based on the Bundesbank Act.

8. Since the 1990s, in the member states of the EU the legal rules about central bank independence show more and more similarities and it can be generally pointed out that independence levels of central banks in ESCB are almost equivalent. Naturally it does not mean that no national peculiarities could be observed, especially in the different aspects of independence. It is more the case that applying the principles of independence compiled by the Working Group of Legal Experts of the European Monetary Institution significantly reduced the diversification in the acts of national banks which also resulted in the general rise

of the level of independence. However, this process can be considered as the convergence of national banks' aggregate development curves into the same point.

9. Observing the development and convergence only in the field of personal independence of EU central banks we find significant positive rise in the level of independence, but the monotone decrease in heterogeneity of legal rules cannot be observed. As far as the general level of personal independence has increased permanently since WWII (which was verified statistically in my dissertation), the heterogeneity of legal rules after a dramatic decrease between WWII and the beginning of 1990s has slightly increased from the 1990s until nowadays. This finding suggests that national peculiarities are mainly present in the field of personal independence.

10. In the case of EU central banks, among the three fields of central bank independence the most powerful convergence can be observed in the field of financial independence. It is supported by the fact that general level of financial independence have increased in a monotone and significant way from the end of 19th century until nowadays and beside the heterogeneity of legal rules has decreased to a minimal level (with the only exception of the traditionally different legal instruments of Great-Britain).

The expected benefits of my research results:

1. I intend to continue my research also among the countries which are not member states of the European Union. Anyway, I consider the exploration very interesting whether the development of central bank independence shows convergence in the case of countries, which are not members of the EMU and in this manner do not have obligations for harmonisation. It is evident that it is impossible to investigate all the countries outside the European Union, but I think we can compose adequate picture about the aspects of CBI, if the examination will involve the Federal Reserve System in the USA, the National Bank of Japan – we know that Japan has dominant position in world economy –, the Central Bank of China, which country is considered to have more and more significant economic potential, as well as the central banks of Australia and New-Zealand.

2. I have published many of my results which are gained during my research activity and writing my dissertation in the forms of presentations on international PhD conferences (14) and papers in professional periodicals (16).

3. I can make use of my research activity in my educational work too. Since 2004 I teach “Special aspects of the regulatory framework in the European Union I-II.” as a compulsory and “International Finance” as an optional subject for students of economics in Eszterházy Károly College. This latter subject has also been taught for students of economics in Heller Farkas College since four semesters.

4. For both of the above mentioned subjects lecture notes were published, which also contain some parts of my dissertation.

5. I plan to publish as a collected work those legal sources which were gathered and translated during my research as well as the comparative-analytical tables in order to ensure a helpful source for further researches carried out in this field.

IV. Publications related to the subject of my dissertation

Scientific studies

1. A jegybanki függetlenség vizsgálata. (*Analysis of Central Bank Independence.*) Európa 2002. III/2. ISSN 1585-9096. 2002. p. 80-94.
2. A jegybanki függetlenség vizsgálata a Magyar Nemzeti Bank példáján keresztül. (*Analysis of Central Bank Independence through the Example of the Hungarian Central Bank.*) Miskolci Doktoranduszok Jogtudományi Tanulmányai. Tomus 1/2. Bíbor Kiadó. ISSN 1588-7901. 2002. p. 289-321.
3. Az 1924. évi V. – A Magyar Nemzeti Bank létesítéséről és szabadalmáról szóló – törvénycikk kialakulásának és tartalmának elemzése. (*The Analysis of the History and Content of the Act V of 1924 on the Hungarian National Bank.*) Miskolci Doktoranduszok Jogtudományi Tanulmányai. Tomus 2/2. Bíbor Kiadó. ISSN 1588-7901. 2002. p. 203-230.
4. The Autonomy of the Hungarian Central Bank in Connection with the Requirements of the European Union. Second International Conference for Young Researchers. Thesis Volume. Gödöllő. ISBN 963 9483 06 9. 2002. p. 304-310.
5. A jegybanki függetlenséget mérő mutatók elméleti összehasonlítása. (*The Theoretical Comparison of Indexes Measuring Central Bank Independence.*) Doktoranduszok Fóruma GTK konferenciakötet. 2002. p. 50-55.
6. Az Európai Központi Bank felállítását követő változások az EU tagállamok és a csatlakozásra váró országok jegybanki függetlenségében. (*Changes in the Central Bank Independence of EU Member States and Candidate Countries after the Establishment of European Central Bank.*) Doktoranduszok Fóruma ÁJK konferenciakötet. 2002. p. 192-200.
7. Jegybanki függetlenség és a bankfelügyelet összefüggései az Európai Unió tagállamaiban. (*The Links between Central Bank Independence and Bank Supervision in the Member States of the EU.*) Hitelintézeti Szemle 2003/2. p. 75-94.
8. A maastrichti értelemben vett jegybanki függetlenség. (*Central Bank Independence in the Sense of the Maastricht Treaty.*) Collega VII. évfolyam/1. 2003. p. 89-94.
9. Jegybanki fejlődéstörténet hatása a jegybanki függetlenségre. (*The Effect of Central Bank Development on Central Bank Independence.*) A II. Országos Közgazdaságtudományi Doktorandusz Konferencia Tanulmánykötete. 2003. p. 382-389.
10. Development Tendencies in the European Bank-systems in Point of View of the Central Banks. 6th International Science Conference. EDAMBA Thesis Volume. Strázovska, E. (ed.), EKONÓM. Bratislava. ISBN 80-225-1743-7. 2003. p. 403-406.
11. Challenges in the Hungarian Bank-system. 4th International Conference of PhD Students. University of Miskolc. Economics I. ISBN 963-661-588-8. 2004. p. 423-428.
12. Central Bank Independence – Legal and Practical Aspects. 4th International Conference of PhD Students. University of Miskolc. Law. ISBN 963-661-594-2. 2004. p. 121-126.
13. Jegybanki függetlenség kontra(?) elszámoltathatóság. (*Central Bank Independence versus(?) Accountability.*) Doktoranduszok Fóruma. ME-ÁJK konferenciakötet. ISBN 963-9360-19-8. 2004. p. 310-316.

14. Historical Aspects of Central Bank Independence. 7th International Science Conference. EDAMBA Thesis Volume. Strázovska, E. (ed.). EKONÓM. Bratislava. ISBN 80-225-1882-4. 2004. p. 356-363.
15. Central Bank Independence in the Act on the Romanian National Bank. „Integration and Globalization” International Conference. The International Session of Scientific Papers. Vol. III. Law and Public Administration Section. University of Pitesti. ISBN 973-690-385-0. 2005. p. 45-49.
16. A Sveriges Riksbank a kezdetektől napjainkig (1668-2004) – A jegybanki fejlődés svéd modellje. (*The History of Sveriges Riksbank (1668-2004) – The Swedish Model of Central Bank Development.*) Miskolci Doktoranduszok Jogtudományi Tanulmányai. Tomus 6/2. Bíbor Kiadó. ISSN 1588-7901. 2005. p. 123-136.

Conference presentations

1. The New Hungarian Central Bank Act and the EU Banklaw – 22nd SVOC International Student Conference. Nové Zámky (Szlovákia). 2001.
2. The Third Period of the EMU-monetary Integration – EDAMBA 5th Conference for PhD Students. Nové Zámky (Szlovákia). 2002.
3. The Hungarian Bank-system in the Point of View of the EU-integration – International PhD Conference. Kosice (Szlovákia). 2002.
4. The Autonomy of the Hungarian Central Bank in Connection with the Requirements of the European Union – Second International Conference for Young Researchers. Gödöllő. 2002.
5. Az Európai Központi Bank felállítását követő változások az EU tagállamok és a csatlakozásra váró országok jegybanki függetlenségében (*Changes in the Central Bank Independence of EU Member States and Candidate Countries after the Establishment of European Central Bank.*) – Doktoranduszok Fóruma a Magyar Tudomány Napja alkalmából. Miskolci Egyetem – ÁJK. 2002.
6. A jegybanki függetlenséget mérő indexek elméleti összehasonlítása (*The Theoretical Comparison of Indexes Measuring Central Bank Independence.*) – Doktoranduszok Fóruma a Magyar Tudomány Napja alkalmából. Miskolci Egyetem – GTK. 2002.
7. A maastrichti értelemben vett jegybanki függetlenség (*Central Bank Independence in the Sense of the Maastricht Treaty.*) – Jogász Doktoranduszok Negyedik Szakmai Találkozója. ELTE – ÁJK. 2002.
8. Jegybanki függetlenség kontra(?) elszámoltathatóság (*Central Bank Independence versus(?) Accountability.*) – Doktoranduszok Fóruma a Magyar Tudomány Napja alkalmából. Miskolci Egyetem – ÁJK. 2003.
9. Development Tendencies in the European Bank-systems in the Point of View of the Central Banks – 4th International Conference of PhD students. University of Miskolc, Law Section. 2003.
10. Central Bank Independence – Legal and Practical Aspects – 4th International Conference of PhD students. University of Miskolc, Economics I. Section. 2003.
11. Jegybanki fejlődéstörténet hatása a jegybanki függetlenségre (*The Effect of Central Bank Development on Central Bank Independence.*) – Magyarország az Európai Unió küszöbén

(Nemzetközi és regionális kihívások) II. Országos Közgazdaság-tudományi Doktorandusz Konferencia. Miskolc-Lillafüred. 2003.

12. Development Tendencies in the European Bank-systems – EDAMBA 6th Conference for PhD Students. Nové Zámky (Szlovákia). 2003.
13. Historical Aspects of Central Bank Independence – EDAMBA 7th Conference for PhD Students. Nové Zámky (Szlovákia). 2004.
14. Central Bank Independence in the Act on the Romanian National Bank. – „Integration and Globalization” International Conference. Law and Public Administration Section. University of Pitesti (Románia). 2005.