



National Bank of Serbia

**Economic governance in Europe
and EU accession process:**
What is the Role of Central Banks?

Conference proceedings

27 and 28 May 2015
Belgrade

KAKŠNA JE VLOGA CENTRALNIH BANK
KOJA E ULOGATA NA CENTRALNITE BАНКИ
MERKEZ BANKALARININ ROLÜ NEDİR
CILI ĖSHTĖ ROLI I BANKAVE QENDRORE
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Народна банка Србије



Implemented by:

giz Deutsche Gesellschaft
für Internationale
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Issuer and copy right holder

National Bank of Serbia
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Place and date of issue

Belgrade, November 2015

Design and Layout

Biljana Stupar, Manoscritto

Printed by

Dina

Circulation

600

This publication is produced with the support of the German Federal Government through Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH and its project "Support to the EU Accession Negotiations in Serbia".

CIP - Каталогизација у публикацији -
Народна библиотека Србије, Београд

338.2(4-672EU)(082)

341.217.02(4-672EU:497.11)(082)

340.137:336.71(4-672EU)(082)

КОНФЕРЕНЦИЈА Економско управљање у Европи и процес
приступања Европској унији: која је улога централних банака?
(2015 ; Београд) Економско управљање у Европи и процес
приступања Европској унији :

која је улога централних банака? : зборник радова са
конференције, 27. и 28. мај 2015. Београд / [организовала]
Народна банка Србије ; [уредници Јоргованка Табаковић,
Мојмир Мрак]. - Београд : Народна банка Србије, 2015
(Београд : Дина). - 89, 87 стр. ; 21 cm

Текст штампан у међусобно обрнутим смеровима. - Насл. стр.
приштампаног енгл. превода: Economic governance in Europe
and EU accession process. - Тираж 600.

ISBN 978-86-85277-18-4

1. Народна банка Србије (Београд)

а) Европска унија - Економска политика - Зборници б)

Европска унија - Придруживање - Србија - Зборници с)

Банкарство - Хармонизација - Европска унија - Зборници

COBISS.SR-ID 219929100



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Moderator: Mojmir Mrak, Jean Monnet Chair Professor, Faculty of Economics, University of Ljubljana

Participants (in alphabetical order of countries and positions):

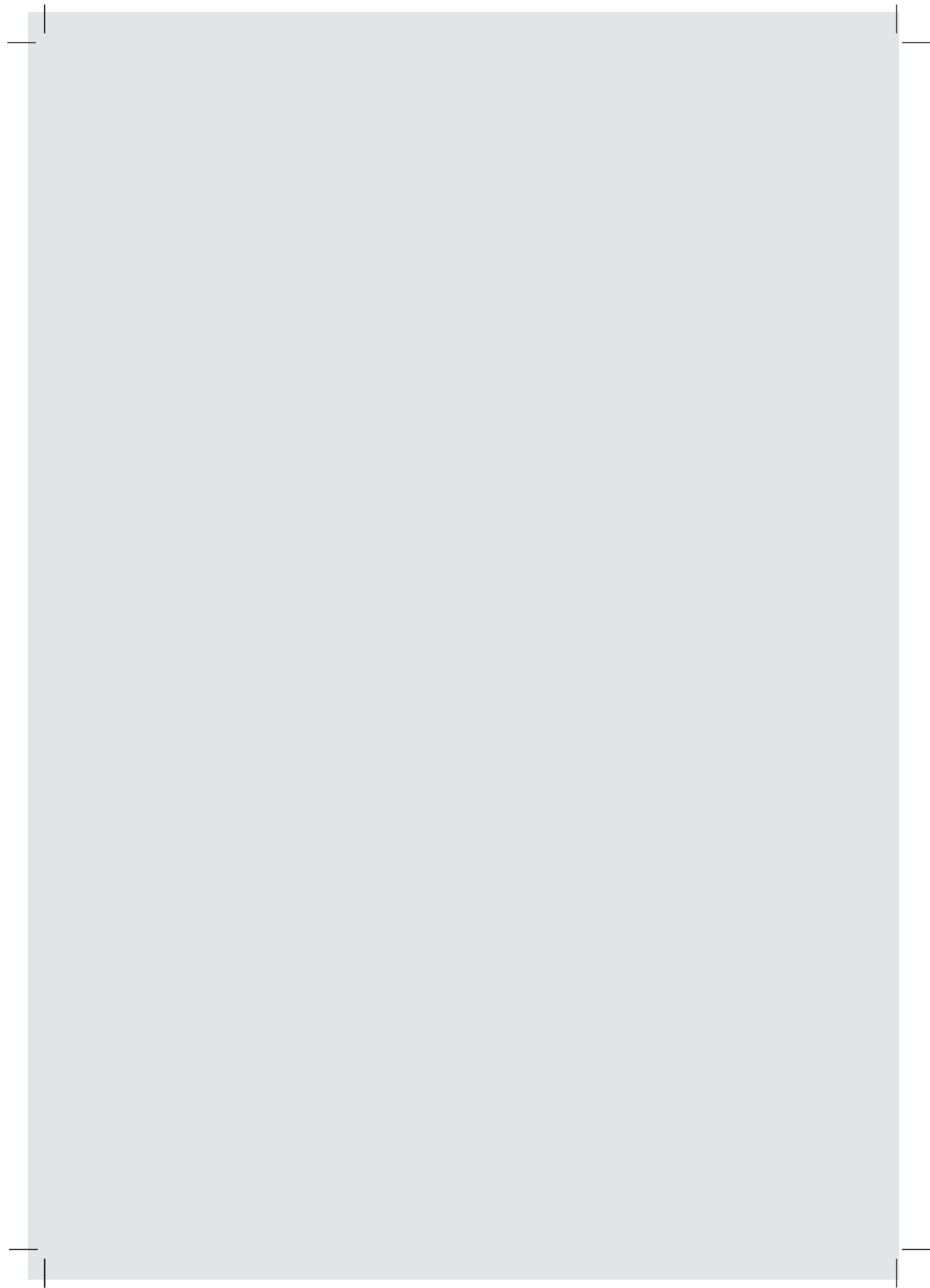
- Gent Sejko – Governor, Bank of Albania
- Milojica Dakić – Governor, Central Bank of Montenegro
- Jorgovanka Tabaković – Governor, National Bank of Serbia
- Ernadina Bajrović – Vice Governor, Central Bank of Bosnia and Herzegovina
- Maja Kadievaska Vojnović – Vice Governor, National Bank of Macedonia
- Mejra Festić – Vice Governor, Bank of Slovenia
- Turalay Kenç – Deputy Governor, Central Bank of the Republic of Turkey

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I. Introduction

I. Background

Since 2008, the global economy has been hit by several shocks following the banking, financial and overall economic crisis. The crisis has strongly affected the euro area (countries using the euro as their currency), non-euro area members of the EU and also the countries that are in the process of accession to the EU. Though the problems have different aspects in different countries, there are also strong common denominators, such as excessive debt, high unemployment and weak economic growth.

The crisis has clearly exposed strong economic interdependence between the EU and the surrounding countries. Also, the crisis has confirmed that the existing structure of economic policy coordination is inappropriate for the high level of regional economic integration the EU has achieved over the recent decades. It is within this framework that economic governance of the EU, and especially of the euro area, has drastically changed over the recent years. Instead of focusing on narrowly defined fiscal objectives and using rather loose decision making mechanisms, the new, reformed economic governance of the EU is much broader in substance terms. In fact, countries have embarked on a complex process of addressing macroeconomic imbalances and fiscal programming deficiencies, in procedural terms as well, and the EU institutions now have more effective powers of supervision and enforcement over national government budgets.

The new economic governance of the EU has started to trickle down to the EU candidate countries. The subject has also become an important integral part of the EU accession processes. On the one hand, dialogue between candidate countries and the EU institutions on macroeconomic, fiscal and structural policy issues will in future be significantly more complex than it once was. In 2014, candidate countries were for the first time asked to prepare their Economic Reform Programmes to be used as a basis for a strengthened policy dialogue with the EU framed within the new economic governance features of the EU. Changes will be reflected in the EU accession negotiations as well, especially in Chapter 17. In contrast to previous EU accession negotiations, the *acquis* of this chapter has become much more demanding than in was before the crisis.

II. Conference objective and participants

With the objective to discuss the European economic governance as the subject of growing importance not only for Serbia but for all EU candidate countries, the National Bank of Serbia has decided to organise a high level international conference **“Economic governance in Europe and EU accession process: What is the Role of Central Banks”**. The Conference, which took place in Belgrade on 27 and 28 May 2015 and was organised with the assistance of GLZ, gathered governors and other high-ranking central bank officials from the EU candidate

countries and selected EU member states from the region, high-ranking officials from the European Central Bank and the European Commission, and representatives of the Serbian administration, other institutions and academia. The Conference was open to media and was attended by some 150 participants.

III. Overview of the topics addressed at the Conference

The Conference consisted of sessions and the governors' panel and took place on Wednesday afternoon, 27 May, and Thursday morning, 28 May. See detailed programme of the Conference in section IV of this Introduction.

3.1. Introductory session: »Serbia on its way to the EU and its economic governance«

The session was fully dedicated to the presentation of the current state of affairs in Serbia's accession to the EU. The three top officials of the country, whose portfolio of responsibilities includes integration into European economic governance, took part in this session and addressed various aspects of this process.

The Conference participants were first welcomed by the Conference host, **Jorgovanka Tabaković**, Governor of the National Bank of Serbia. She thanked all the participants for attending the Conference and invited them to openly share their experiences and opinions to help create a joint overview of the common EU accession-related challenges as well as those dealing with the enhancement of our economic policies. Ms. Tabaković stressed the relevance and topicality of the theme of the Conference in view of the global economic crisis that brought into focus the strong interdependence between the EU and the surrounding countries, as well as the importance of enhancing the existing structures for the coordination of economic policies.

The next speaker at this session was **Jadranka Joksimović**, Minister Responsible for European Integration. In her address, she tackled all important segments of Serbia's accession process, including the recently completed screening process and preparation for the opening of the first negotiating chapter. Ms. Joksimović also emphasised the significant role of the National Bank of Serbia in the negotiation process, as well as the importance of the regional cooperation and regional component of the European integration process.

In conclusion, the session was addressed by **Dušan Vujović**, Minister of Finance of the Republic of Serbia who shared with the audience information about the progress in the implementation of the stand-by arrangement Serbia signed with the IMF at the beginning of the year and provided his views on the first ERP produced in the context of the reformed European economic governance. Mr. Vujović gave detailed explanations and commented on the EU's assessment of Serbia's ERP.

3.2. First working session: »European economic governance – new approach«

In contrast to the previous session that focused on Serbia, the First working session was devoted to the European economic governance and especially to changes in its structure introduced as a consequence of the recent crisis. The three speakers, two from the key European institutions with a mandate on European economic governance and one from the academia, were invited to make their contribution to the Conference.

The first speaker on the program was **Istvan Jakab**, Head of Unit for Candidate and Pre-candidate Countries, DG ECFIN, European Commission. In his presentation, he outlined a historical and conceptual framework for multilateral surveillance in candidate countries, and concentrated on Economic Reform Programmes. He explained the rationale for these documents, their content and timeline and presented a brief overview of the 2015 ERP and the Commission's assessment.

The next speaker who addressed the Conference was **Gilles Noblet**, Deputy Director General for International and European Integration, European Central Bank. In his presentation, he explained the monetary policy measures that the ECB implemented in response to the crisis, as well as the new responsibilities of the ECB in the context of the banking union and the role of the ECB in the EU accession process and euro area enlargement. Mr. Noblet stressed the commitment of the ECB to support the smooth integration of the National Bank of Serbia into the European System of Central Banks.

The last speaker of the day was **Mojmir Mrak**, Jean Monnet Chair professor, Faculty of Economics, University of Ljubljana, Slovenia and GlZ expert at the Conference. The focus of his presentation were the two main channels through which the reformed European economic governance influences the EU candidate countries. One is the broadened dialogue of a candidate country with the EU on economic policies based on Economic Reform Programmes, and the other are EU accession negotiations under Chapter 17.

3.3. Second working session: »National Bank of Serbia in the EU accession negotiation«

This session aimed to present the role National Bank of Serbia plays in the EU accession process of the Republic of Serbia. In his presentation, **Zoran Nišavić**, General Manager of the International Relations Department of the National Bank of Serbia explained the significant role and the activities of the National Bank of Serbia in all phases of this process, with a particular focus on the recently completed screening exercise. He also spoke about the projects implemented in cooperation with the ECB/ESCB aimed at conducting operational preparations for the participation of the National Bank of Serbia in the ESCB, once the Republic of Serbia joins the European Union.

¹ Due to his late arrival caused by logistical problems on the departing airport, his presentation was actually delivered on Thursday, 28 May 2015 as part of the Second working session

3.4. Panel with Governors and Vice Governors: »Role of Central Banks in the EU integration process and upon entering the EU«

The highlight of the Conference was the panel on the “Role of Central Banks in the EU integration process and upon entering the EU”. The governors from all EU candidate countries as well as those from selected EU member states were invited to participate. The main focus of the panel were the interlinkages between the new European economic governance and the EU accession process of the countries from the region with a special reference to the role of central banks in these processes. Among others, the following questions / topics were suggested for the panel discussion:

- What kind of challenges central banks of EU member states and candidate countries face with the new economic governance of the EU?
- How should central banks be integrated in the preparation of the Economic Reform Programmes? Which areas are to be covered by central banks?
- What is the role of central banks in the EU accession negotiations in general (negotiating groups, core negotiating teams, other structures), and especially as regards Chapter 17?
- Should central banks in the region cooperate on a more systematic basis on the subject of European economic governance? If yes, what forms of cooperation would be appropriate?

The participants in the panel discussion were invited to present their views on one or more of these questions / topics and also to introduce into discussion some other specific topics they deem appropriate for the overall subject of the panel.

The panellists were strongly encouraged to provide their valuable contributions to the panel in the form of ad-hoc “on the floor interventions”. Written contributions were not expected and power point presentations were not possible for technical reasons. In cases where written contributions were prepared, they were distributed to the audience and are attached as an annex to these Proceedings.

The governors and vice governors from seven countries took part in the panel. More specifically, the panel was moderated by Mojmir Mrak, Jean Monnet Chair Professor, Faculty of Economics, University of Ljubljana and consisted of the following governors and/or vice governors (in alphabetical order of countries and positions): (i) Gent Sejko – Governor, Bank of Albania, (ii) Milojica Dakić – Governor, Central Bank of Montenegro, (iii) Jorgovanka Tabaković – Governor, National Bank of Serbia, (iv) Ernadina Bajrović – Vice Governor, Central Bank of Bosnia and Herzegovina, (v) Maja Kadievski Vojnović – Vice Governor, National Bank of Macedonia, (vi) Mejra Festić – Vice Governor, Bank of Slovenia, and (vii) Turalay Kenç – Deputy Governor, Central Bank of the Republic of Turkey.

While the main topics addressed and messages passed by each of the panellists – as identified by the editors of these Proceedings – are presented in the continuation of this Introduction, a summarized transcript of the panel is provided in the respective chapter of the Proceedings.

- Gent Sejko – Governor, Bank of Albania; He informed the panel about the wide set of activities the central bank performs in the context of economic governance and

especially about the chapters 9, 16 and 27 of the negotiations and focused on two major concerns they are faced with within this context. The first one is the ability of the central bank to produce forecasts, reports and projections regarding different kinds of reports for monetary policy, financial stability and other central banking roles which are in compliance with the requirements of the EU governance process. And the second one is the cooperation, within and outside the central bank, with the European Commission, with EU member state central banks and also regionally with central banks of the candidate countries.

- Milojica Dakić – Governor, Central Bank of Montenegro; As his country is already deep in the EU accession negotiation, the governor focused on the current state of the negotiations and explained the role the central bank has in this process. The central bank coordinates five of the negotiating chapters, of which two have already been opened, while its staff is actively involved in another nine negotiating chapters. The governor specifically addressed the subject of the negotiations under the chapter 17 that focuses on the economic governance issues. Montenegro faces one significant challenge within this area and this is introduction of ESA 2010 standards.
- Jorgovanka Tabaković – Governor, National Bank of Serbia; Her introductory intervention was composed of two parts. In the first one, she addressed the role central banks typically have in the EU accession. When designing institutional structure for the negotiations in Serbia, the example of Croatia with the strong role of the central bank in the negotiations was taken as kind of guidance. There are several reasons that justify this approach, including the growing importance of the ECB and national central banks in the overall EU economic governance structure and in the crisis management. In the second part of her intervention, the governor shared her views on the reformed economic governance of the EU. Within this framework she emphasized the importance of prudent national fiscal policies.
- Ernadina Bajrović – Vice Governor, Central Bank of Bosnia and Herzegovina; Her intervention started with informing the panel about the current economic and EU accession status of Bosnia and Herzegovina. She underlined the importance of the recently signed political agreement to intensify both economic reforms and the European integration process. The agreement is considered to be of crucial importance for Bosnia and Herzegovina to embark, in cooperation with international financial institutions, the European Union and the international community as a whole, on highly needed structural reforms. The central bank stands ready to be an active partner in this process, even though its monetary policy mandate is rather limited within the currency board environment.
- Maja Kadievaska Vojnović – Vice Governor, National Bank of Macedonia; The vice governor expressed her strong disappointment with the fact that Macedonia remains blocked in its EU accession process. The country namely has been an EU candidate country for ten years and has six consecutive recommendations of the European Commission for starting the EU accession negotiations. This disappointment is even stronger in view of the fact that Macedonia performs rather well in economic terms what has been documented well in its recent Economic and Reform Programme. As

underlined by the vice governor, Macedonia is assessed by international financial institutions as a good economic governance performer and is a country which has, at this moment, the highest economic growth rate in the region.

- Mejra Festic – Vice Governor, Bank of Slovenia; Being the only representative from a central bank of a country that is part of the euro area, she focused her introductory intervention on challenges faced by Slovenian policy makers, and especially the central bank, in the context of the recent crisis. She discussed the pre-crisis credit boom environment, presented the problems Slovenia faced with the growing proportion of NPL within bank portfolio and with worsening of the country's fiscal and public debt position. In order to embark on a sustainable fiscal consolidation, she claims, Slovenia has to embark vigorously on the restructuring of its corporate sector. It should involve three aspects – business restructuring, governance restructuring, and ownership restructuring.
- Turalay Kenç – Deputy Governor, Central Bank of the Republic of Turkey; His introductory presentation was focused on three points. The first one dealt with structural reforms. There are basically two ways of strengthening the resilience of your economy against financial and economic shocks. One is to have a stable financial system and rules, and another one is to intensify structural reforms what is going to lift the potential growth of the economy. Both are important and interrelated. The second point, again related to the global financial crisis, was the problem of macro policy coordination at international level. And the final point was on the importance of how economic governance decisions are being communicated to the public.

There was a strong consensus among the panellists that the Conference addresses an increasingly important topic that will have a strong impact on economic development of the countries in the region in the forthcoming period and especially as regards their EU accession process. It was equally strongly underlined that the role central banks have in the processes of both harmonisation with the European economic governance requirements and the EU accession negotiations, is becoming increasingly important. And finally, an interest was expressed that governors and vice governors from the region should meet on a regular basis in order to discuss those specific aspects of the European economic governance and EU accession negotiations that are of particular interest to central banks.

3.5. Concluding remarks

In her closing remarks, Jorgovanka Tabaković, Governor of the National Bank of Serbia and the host of the Conference said that the Conference exceeded our expectations and helped us perceive the challenges of regional central banks on their path to the European Union. She thanked all the participants and the Conference panellists, representatives of European institutions, GLZ, and in particular Mr. Mrak for providing guidance in the panel discussion and in organising the event.

IV. Conference programme: sessions and governors' panel

Introductory session: »Serbia on its way to the EU and its economic governance«, Wednesday, 27 May 2015

- *Opening address*; Jorgovanka Tabaković, Governor, National Bank of Serbia
- *The current status of Serbia's EU accession process*; Jadranka Joksimović, Minister Responsible for European Integration
- *National Economic Reform Programme of the Republic of Serbia 2015 – 2017*; Dušan Vujović, Minister of Finance of the Republic of Serbia

First working session: »European economic governance – new approach«, Wednesday, 27 May 2015

- *Reformed economic governance as part of the preparation for membership of the European Union*; Istvan Jakab, Head of Unit for Candidate and Pre-candidate Countries, DG ECFIN, European Commission
- *The European Central Bank in the new economic governance framework of the European Union*; Gilles Noblet, Deputy Director General for International and European Relations, European Central Bank
- *European economic governance and implications for EU candidate countries*; Mojmir Mrak, Jean Monnet Chair Professor, Faculty of Economics, University of Ljubljana

Second working session: »National Bank of Serbia in the EU accession negotiation«, Thursday, 28 May 2015

- *Experience and the role of the National Bank of Serbia in the EU accession process of the Republic of Serbia*; Zoran Nišavić, General Manager of the International Relations Department, National Bank of Serbia

Panel with Governors and Vice Governors: »Role of central banks in the EU integration process and upon entering the EU«, Thursday, 28 May 2015

- Moderator: Mojmir Mrak, Jean Monnet Chair Professor, Faculty of Economics, University of Ljubljana
- Participants (in alphabetical order of countries and positions):
 - Gent Sejko – Governor, Bank of Albania
 - Milojica Dakić – Governor, Central Bank of Montenegro
 - Jorgovanka Tabaković – Governor, National Bank of Serbia
 - Ernadina Bajrović – Vice Governor, Central Bank of Bosnia and Herzegovina
 - Maja Kadijevska Vojnović – Vice Governor, National Bank of Macedonia
 - Mejra Festić – Vice Governor, Bank of Slovenia
 - Turalay Kenç – Deputy Governor, Central Bank of the Republic of Turkey

Closing session, Thursday, 28 May 2015

- Concluding remarks by the host, Jorgovanka Tabaković, Governor, National Bank of Serbia.

V. Contents of the Proceedings

Following this *Introduction*, the Proceedings are structured according to the Conference programme. First, the three contributions from the *Opening session* are presented, followed by the three papers from the *Working session*. The Proceedings continue with the transcript of the *Governors' Panel*. The last section of the Proceedings includes the host's remarks made at the *Closing session*.

An *annex* containing contributions of the governors that were prepared on the sidelines of the Panel is attached to the main text of the Conference Proceedings.

Belgrade, November 2015

Jorgovanka Tabaković

Mojmir Mrak

II Introductory session:

»Serbia on its way to the EU
and its economic governance«

Wednesday, 27 May 2015

Opening address

Jorgovanka Tabaković

Governor of the National Bank of Serbia



Ladies and gentlemen,

Esteemed guests and dear friends,

It is a great pleasure for me to welcome you in my name and on behalf of the National Bank of Serbia, as well as an honour to be the host of the international conference “Economic governance in Europe and EU accession process: what is the role of central banks?” over the next two days.

I extend my warmest welcome to the representatives of the Government of the Republic of Serbia – minister of finance and minister responsible for European integration, representatives of the central banks of Montenegro, Albania, Turkey, Macedonia, Bosnia and Herzegovina, Slovenia and Croatia, representatives of the European Commission and European Central Bank, other representatives of the institutions of the Republic of Serbia and all the other guest from Serbia and abroad. I would like to extend sincere thanks and appreciation to the representatives of Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), who have helped us wholeheartedly in organising this event.

In this two-day event, we will focus on the new concept of economic governance in Europe and the changed role of institutions, notably central banks, in running economic policies.

The issue is topical for several reasons. The global economic crisis has revealed strong interdependence between EU member states and their neighbouring countries and has highlighted the importance of improving the existing mechanisms for coordination of economic policies. In this context, new economic governance in the EU also affects candidate countries, since this is an integral part of the accession process. The challenges faced by central banks are increasingly complex, and the role of central banks in the process of EU accession is gaining in prominence and importance.

I am confident that the representatives of EU institutions will explain in their presentations the most important characteristics of the concept of new economic governance.

The aim of the conference is to encourage cooperation and dialogue among central banks of EU candidate countries and prospective candidates in our region in order to identify common dilemmas. I take great pride in the fact that by organising this conference, the National Bank of Serbia has gathered a number of friends from the country and from abroad who share European values and with whom we aim to realise the maximum possible level of cooperation and exchange experiences which will, no doubt, prove invaluable on our path to the European Union.

We are witnesses to a moderate growth of the global economy, supported by low oil prices and depreciation of some currencies, as well as to numerous challenges stemming from the lingering consequences of the economic crisis, insufficient level of investment and persistent uncertainties in financial markets.

As regards the Republic of Serbia, the position of the Government and the National Bank of Serbia is that macroeconomic stability is a key prerequisite for sustainable economic growth in the medium term.

The expected recovery and strengthening of our economy, more stable public finances, a more favourable economic environment, and a rise in investments, employment and the standard of living will bring Serbia closer to the European Union. Robust fiscal consolidation and implementation of a comprehensive set of reforms to remove structural weaknesses in the economy will enable gradual but lasting fulfilment of the conditions for achieving nominal and real convergence.

The recently concluded stand-by arrangement with the International Monetary Fund intended for precautionary purposes is of great importance for our country. The economic programme agreed with the International Monetary Fund is based on three pillars: restoring the health of public finances by implementing fiscal consolidation, increasing the stability and resilience of the financial sector, and strengthening competitiveness and economic growth by implementing structural reforms.

The initial results of these measures are on the positive side as also confirmed by the reactions in the financial market which ensued right after the arrangement was agreed. Namely, already at that time, Serbia saw a decline in yields on its government bonds, an increase in the demand for dinars and consequently, the strengthening of the national currency. The effects of the application of agreed measures have already reflected on the reduction of budget deficit in the first quarter this year, and we expect these trends to continue in the period ahead. The latest data which indicate a recovery in economic activity in late 2014 and early 2015, led primarily by rising exports, also give us reason for optimism.

I am fully confident that the Government and the National Bank of Serbia will give their best to honour their commitments and that the arrangement will be successfully completed within the planned three-year period.

The National Bank of Serbia, on its part, will continue to make efforts towards achieving and maintaining price and financial stability. Practically for the first time in several decades, we managed to reduce inflation to the level comparable with that in other European countries and to keep it there in the last year and a half. In the coming period, we will strive to bring inflation back within the target tolerance band of $4 \pm 1.5\%$, being at the same time cautious in easing our monetary policy stance because of the risks emanating from the international environment. Also, we are doing our best, together with the advisory assistance and support of the International Monetary Fund and the World Bank Group, to find the most effective solution to the issue of high NPLs and to prevent a further increase in the NPL share in total loans.

Though many measures have been taken and a lot has been done, we are still facing many challenges. I firmly believe, however, that through cooperation built on trust, understanding and resoluteness, we will continue working on ways to address the current economic issues.

Ladies and gentlemen, dear friends,

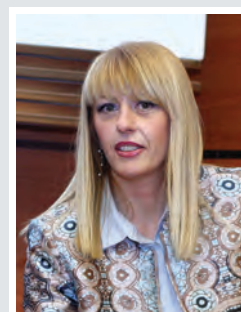
I open this conference with great pleasure and invite you to be open and to share your experiences and views, today and tomorrow, because I am sure that exchange of experiences can help us identify common challenges and enhance our economic policies.

Thank you.

The current status of Serbia's EU accession process

Jadranka Joksimović

Minister Responsible for European Integration



Besides the rule of law and the core values on which the European Union is based, a significant part and the essence of the European integration process represents the shaping and fitting of our economic system in the broadest sense, not only to the standards of the European Union, since they are also subject to a continuous change. This is exactly why the new economic governance is an additional mechanism of the European Union for responding to the problems arising in the EU member states, but also in the candidate countries. In this sense, a conference devoted to the topic of economic governance in Europe and the EU accession process is extremely important.

Membership in the European Union is a strategic goal of the Government of the Republic of Serbia. When we say a strategic goal, we must concretize what this goal actually stands for.

Our goal is the promotion of the quality of life of our citizens, which is reflected in the rise of the standard of living and strengthening of the rule of law and democratic institutions, as well as the creation of a responsible and functional state. Hence, the enhancement of the quality of life in the widest and most simple sense.

This is exactly why it is so important to conduct the European integration process in such a way that progress toward membership corresponds to the increase in the standard of living of the citizens and to the enhancement of their rights. For this reason, we often emphasise that

the membership in the European Union is a support to the efforts of our Government to improve the quality of life in our society. I believe that the Government has adopted a good, euro-realistic approach that takes into account all the good things in the European Union.

At the same time, as a candidate country which is in the negotiating process, we monitor the changes taking place in the European Union itself, as well as the way in which the European Union searches for mechanisms to respond to the issues and challenges which, among other things, relate to the new economic governance.

The accession negotiations themselves, which represent rather an attempt to set the most appropriate deadlines and find ways to adjust to the standards of the European Union, are truly the best corrective to any government and any candidate country, and represent a guidance for the work that we ourselves must do. The European Union will not implement the fiscal consolidation measures for us, nor programme the economic areas in which we could generate growth, nor provide us with concrete solutions. Simply, we ourselves must build the grounds for a healthy society and a healthy state that will become a functional member of the European Union. Because of this, it is important to understand the key criteria that we as a society must work on.

The first criterion is the rule of law – the widest set of values which includes the political Chapters 23 and 24, of which we speak all the time. They include all the things that make the groundwork of a democratic society – fight against corruption, judicial reform, fight against organised crime, strengthening minority rights and freedom of the media.

The second criterion is the reform of public administration. This refers not only to the public administration reform, but also to the reform of the entire public sector. The public administration reform is a great challenge for our country and actually an obligation, without which we would hardly succeed in putting our public sector on a solid foundation.

The third group of criteria refers to the new economic governance. It involves not only, like many people like to say, tightening the belt, but comprehensive structural reforms. It includes the broadest range of structural reforms and public policy measures that should enable the growth of GDP. They are partially defined in the first pilot year through the Economic Reform Programme, which was initially named the National Economic Reform Programme, by which we have, through preparing it, de facto entered into what is called the European semester (I say de facto, i.e. informally, since we are a candidate country). In that way, the European standards in this area as well will be of extreme importance for us as the candidate country.

As far as the status of our European integration process is concerned, it is important to know that we have successfully completed the screening process, i.e. the process of analysis and aligning of the domestic legal framework with the EU acquis. We completed it in less than two years. We have shown good administrative capacity, i.e. the administration has shown that it is capable of analysing the legal framework within a short time frame and, more importantly, that it is able to align the legal framework with what we call the European acquis, shaped in the European standards and partly in the European legal framework.

On this occasion I will not speak about the deadlines, although I am frequently asked about them as the minister for European integration. The only deadline that is certain for us is the end of 2018. We have committed ourselves through our national document for the adoption of the *acquis* that we will completely align our legal framework with the European legal framework by this date.

We are working hard and are committed to achieve this. Everything above and beyond are the things that are subject to detailed negotiations, and ultimately represent a part of the political environment and messages coming from the European Union itself.

Our job is to work well and to fulfil these three conditions – the rule of law, public administration reform and the new economic governance. Once we do this, we will be ready to become a functional member of the European Union in five, six or seven years. Let us not speak of the deadlines at this point.

The role of the National Bank of Serbia in the negotiation process is very significant, starting from the opening of negotiations, the screening process, to the EU accession.

Considering that a stable and developed banking sector is a very important segment of economic reforms, numerous chapters refer exactly to these issues, and four or five chapters refer directly to the competences of the National Bank of Serbia. The representatives of the National Bank of Serbia have, however, participated in nine negotiating groups within the negotiations with the European Union and given a significant contribution to the analysis of the *acquis* by presenting the Serbian legal framework and familiarizing with the European legal framework. In this context, we have decided to appoint a representative of the National Bank of Serbia in the negotiating team, who will cover several areas and have expert and technical support in the form of technical groups.

When it comes to results, an efficient central bank has a significant role in the creation of a stable financial sector and its reliable and high quality functioning is one of the key preconditions for achieving macroeconomic stability in the country.

The National Bank of Serbia has shown quality and reliability that represent a good foundation for long-term decision-making and securing macroeconomic stability in the country. It is needless to say how significant this is for us as a candidate country, primarily for our citizens, and in the context of European integration as well.

The areas in which the National Bank of Serbia has an important role in the negotiating process are: free movement of capital, company law, competition policy, financial services, economic and monetary issues, statistics, consumer protection, financial control and financial and budgetary issues.

All these chapters are important for the macroeconomic stability and arrangement of the overall economic state of affairs in the country.

It should be noted that the so-called convergence criteria, which are a standard of the European Union, are very important for us as a candidate country. The convergence criteria

are rather strict and precise and refer to what a country that aspires to become an EU member state must adhere to. It is important to show that we, as a candidate country, have strong financial discipline and that we can fulfil these criteria. The fulfilment of convergence criteria and maintaining the macroeconomic parameters at a stipulated level is a key precondition for economic stability, and even for economic development of the countries of the eurozone, as well as of the candidate countries.

One of the criteria is the level of budget deficit that should not exceed 3% of GDP and another is the level of public debt that should not exceed 60% of GDP.

When it comes to budget deficit, we have shown that by implementing concrete measures we managed to achieve concrete results in the first quarter of the year. This is outstanding for a candidate country and shows seriousness and readiness to achieve financial discipline in order to meet the economic criteria of the European Union.

This is very important having in mind that due to the experience with the previous EU enlargement, in relation to which I will not mention concrete cases or states, there is a sentiment in the European Union that some countries were not fully prepared to join the EU in the economic and financial sense, and that they have not shown the level of required functionality.

This is why the criteria have been tightened. I have to say that the policy of the Government of the Republic of Serbia that has put emphasis on these important issues in the past year is highly appreciated.

The inevitable issue with which I will conclude is a very important regional dimension of the European integration and the regional cooperation – regional cooperation in different areas which really supports our joint path to the European Union.

Although I believe that each country should be evaluated by its own achievements, on a merit-based principle, regional cooperation is indispensable for us as candidate countries or candidates for candidates, and without it we will hardly ever join the European Union.

This is why the story of the common infrastructure and connectivity established through the Berlin process is positive. It can contribute to the improvement of the regional relations in those areas that are burdened by bilateral issues.

The regional cooperation of central banks is extremely important and contributes significantly to the stability of the region and to macroeconomic stability in general.

The National Bank of Serbia at the same time cooperates with the European System of Central Banks, particularly the European Central Bank, with the aim of aligning its operations with the standards of central banks, which at the same time represents an obligation for every candidate country.

Added value in this whole process is precisely the regional cooperation of central banks.

This is why I, as minister in charge of European integration and integration is a comprehensive process, support this initiative of the National Bank of Serbia that is involved in an active and concrete way in the process of European integration, i.e. the negotiation process of Serbia with the European Union. Of course, I welcome GIZ as an important partner that has recognised this regional dimension and its significance, as well as the way in which we should work together for our European future, which is the best framework for the stability of our region.

Thankyou.

Text revised and authorized on November 11th 2015

National Economic Reform Programme of the Republic of Serbia 2015 – 2017

Dušan Vujović

Minister of Finance of the Republic of Serbia



ERP – Economic Reform Program is a very good format to integrate macro- fiscal and monetary policies and structural measures in one document. Almost the same format is applicable to the EU members, to the accession countries, and to partnership countries.

Although it's not quite “one size fits all” ERP offers the same framework, the same policy environment in which we think about macroeconomic stability, macroeconomic policies and structural reforms. This is relevant not only for the accession countries, but also for the countries that have been in the European Union for decades now, including the group of neighboring countries that recently joined the European Union. We have a lot in common with these countries as we either used to be in the same state or undergo similar process of adjustment on the EU accession path.

ERP is a continuation of the two document formats that were used before. The first document preceding ERP was called the PEP (Pre-Accession Economic Program). PEP had almost the same coverage as our regular fiscal strategy program, albeit it offered more detail and analytical depth on select issues. The second document format called NERP integrated PEP as its first part, enhanced by a more comprehensive treatment of macro-monetary policies, and added the second part dealing with macro structural and micro structural measures.

Serbia's ongoing program of economic reforms supported by the International Monetary Fund follows exactly that approach. Admittedly, there is a slight difference in the way we group structural reforms, but the basic idea is the same. Our program has a set of shorter macro fiscal and macro monetary policies, supplemented by a range of structural reforms, that either intend to clean dysfunctional state owned enterprises - the legacy of the socialist past, improve the efficiency of public (mostly utility) companies, or reform the public sector and create a basis for a modern market economy.

However, the ERP format is more forward looking than our reform program. Let me quickly underpin the ERP format and then I'll draw a parallel with the Serbian reform program.

ERP groups structural reforms into four thematic areas. One is physical capital that essentially looks at the status of infrastructure - what is needed for the physical capital to enable a country, either pre-accession country or member country, to effectively compete in Europe.

Number two is human capital, the presence of the knowledge economy, the quality of the education system, the ability of the economy to be productive and competitive. So, the essential question is: Do we have the labor force that has sufficient education level and ability to be competitive in European and world markets?

Number three is the industrial structure, including access to finance. Industrial structure in Europe is a key question of staying competitive. Countries use smart specialization to stay competitive in the fast evolving world markets. In the case of Serbia, we must first resolve the legacy of the past – dysfunctional state owned enterprises that we inherited from the socialist era.

And finally, it is the quality of the overall business environment where we seem to share the same problems. Europe has its own weaknesses caused by overextended social protection and welfare compared to countries that are leaders in productivity and growth in the world. In addition to ample social protection, Serbia has layers of old legislation that often weaken rather than enhance, block rather than support, destruct rather than create a conducive economic environment for private investment, domestic, as well as foreign.

The ERP program was announced last October and introduced for first time this year. This left very little time to truly gain ownership of the program and recast everything that we are doing in the format of this program. This year, we went through the motions of completing the program and using the ERP format as best we could to identify key development bottlenecks and barriers to growth. Hopefully we will be able to better use this or adapted format next year to effectively define desired outcomes and identify resource and policy gaps.

In preparing part one of the ERP we extensively used our Fiscal strategy for 2015-2017 period, enhanced by the additional inputs from the National Bank of Serbia. The second part built on the status of the sectoral priorities and attempted to explicitly state development objectives, interim and final outcomes as well as missing resource, institutional and policy resources.

Now, let me highlight the main features of our program supported by the International

Monetary Fund. Its first pillar focuses on macro stability and fiscal consolidation and mostly parallels part one of the ERP. The second pillar, which seeks to resolve the status of SOEs, is very close in substance to the industrial structure section of the ERP. The 500 dysfunctional or distressed SOEs companies in the portfolio of the Privatization Agency represent the legacy of the past.

These are companies that have been in a limbo of bankruptcy/liquidation for 10 years or more, protected from the creditors by the Privatization Agency and by the special laws that were later deemed unconstitutional. We finally gathered political will to resolve the status these enterprises and see whether they are able to survive in the market or go down in history. Close to 150 enterprises have already been sent to bankruptcy. The remaining companies will have to face a decision to either find new owners within legally set deadlines or enter bankruptcy procedure. For the 17 largest companies both in terms of employment and production we allowed a reasonable extension of up to one year to find the right partner and conclude successful privatization programs.

The second pillar of our economic program, which looks at the efficiency of public enterprises in utilities (power, gas) and infrastructure (roads, railways, airports) does not have a full equivalent in the ERP format. Portion of infrastructure efficiency is contained in the ERP section on physical capital. This section should address some outstanding issues related to incomplete infrastructure projects which engage (actually block) huge public resources without providing expected infrastructural services that are essential for Serbia ability to compete in the EU. In some cases the missing sections of only few kilometers are blocking the use of hundreds of kilometers of completed highway. The ERP report is the right tool to identify such bottlenecks and provide the necessary resources to complete or modernize these infrastructure projects. The reform of public enterprises goes beyond completing infrastructure projects and seeks to upgrade the corporate structure and improve management efficiency in these companies. EPS - Power Generation and Distribution Company in Serbia is one case where such improvements are possible. Railways is another.

The third structural area and the fourth pillar of the whole program is the reform of the Public administration and public sector in a wider sense. Only an efficient government can be a credible leader of economic reforms and efficiency improvements in the country. Hence, we are starting a broad based longer term program or reforming the public sector. Diagnostic work will start from the so called horizontal and vertical functional reviews of ministries, agencies and other public sector institutions. It will show how many people are needed to efficiently deliver public services from education and health, to extension services in agriculture to many other things that modern European states deliver including security and defence. The media tends to present these public sector reforms as hardship and sacrifice for the present public sector employees, who may be expected to work more and better. Or even face layoffs. Almost no one talks about the need to improve the quality and lower the cost of public sector services, ease the burden on the taxpayers and the general population. Clearly, there is something wrong with this perception and we will have to work to change it and make the public sector accountable to the people.

Additionally, the new ERP format introduces results orientation. Each of the structural reforms in the second part of the report specifies a result that you want to achieve, list the necessary resources, and identifies a stream of interim steps that one needs to monitor to ensure that the desired outcomes are really achieved. That approach will ensure that transport and infrastructure projects meaningfully connect economic activities and people to add value and increase productivity. That health projects prevent diseases and improve treatment of patients for faster recovery, work ability and better quality of life.

Policies and projects in the area of environmental standards and protection are the most difficult part of the EU accession process. Often these standards are designed for countries at much higher level of income and easy access to cheap capital. To acquire environmentally safe technologies and observe EU environmental standards one needs huge investments which may be beyond reach at this time. But there are areas where advances are easier. For example, Serbia uses a lot of electricity per unit of GDP and the low electricity prices do not provide incentives to invest in energy saving devices (windows, energy efficient bulbs and appliances etc.). A set of easy short-term interventions combined with the adoption of longer-term policies in the coming years will be necessary to comply with the EU standards and stay competitive.

Let me now turn to the specific comments and recommendations from the European Union on the Serbian submission for this year ERP.

First comment was a suggestion to strengthen Fiscal Consolidation by using any excess revenues and current expenditures to reduce budget deficits. As it turned out that was the essence of our program.

Last July, when I took office as minister of finance, our fiscal deficit was 8.8% of GDP with a tendency to grow out of control. Nobody believed that we'll be able to contain the deficit and lower it to 6.6% by the year end. At the end of the first quarter the deficit was down to 2% of GDP. At the end of October 2015 the central government deficit is still below 40 billion dinars or 1.2% of GDP and the general government deficit is less than 2.4% of GDP. This is 600 million Euros less than planned and well below the Maastricht's criteria of 3% of GDP. Is this sustainable? The trend is probably not, but the savings are. Our total target for 3 years was to reduce the structural fiscal deficit by about 1.5 billion Euros or close to 4% of GDP. Based on the estimates after ten months, 2.45% or around 3/5 of the overall structural adjustment will have been achieved in 2015. So, we will have an easier adjustment target in second and third year of the program (with ¾% adjustment annually) and could devote our attention to structural reforms that will enter critical implementation stages at that time.

Second comment was on Structural Reforms as we defined them. As I mentioned, we already pushed a large number of SOEs (State - Owned Enterprises) into bankruptcy. We had no choice but to declare bankrupt companies that had no production for so many years. They were on the budget life line for minimum wages and had growing arrears for energy and utility bills, taxes, loan repayments, etc. This burden on the budget estimated at 800 million Euros per annum became unsustainable.

On public enterprises – we are doing comprehensive restructuring programs for EPS and Railways supported by the World Bank DPL which provides a medium (3 – 5 year) time frame to restructure, improve efficiency and better “lean and mean” management. Before the program EPS had 600 managers and 13 profit units, 15% physical (technical) loss and 84% average collection rate. Combined, EPS got paid only for 2/3 of the electricity that entered the system. This was huge inefficiency. Now, less than six months into the program, the collection rates are well over 90% and technical losses are expected to decline rapidly.

Last but not least, Public Administration Reform, a very controversial topic among public servants and even ministers, remains at an early stage. Everybody thinks that rightsizing means just firing people, rather than increasing efficiency, lowering fiscal burden on the public, providing quality education and health services at lower cost. Rightsizing targets are only now being set, but public administration and public sector reform needs to be reinvigorated with an attitude change and supplemented with the necessary legal and fiscal/budget rules. Without consistent delegation of authority and resource management to implementing levels of management, the public administration/sector program is bound to stall in the existing environment in Serbia.

Third comment was on the need to Further Strengthen Public Financial Management, and the last sentence of this was basically to Adopt Eurostat Excessive Deficit Procedure Reporting.

On both fronts we are making good progress. We have completed screening for Chapter 32 on time and have now completed the PFM strategy. We expect that EU resources for the preparation of IPA 2 funding, including sectoral EU budget support, will soon be available. This will prequalify Serbia as an accession country to handle responsibly the finances received from the EU: from planning to monitoring and reporting in line with the EU rules. If done properly, this will enable huge savings and contain the risks.

We have improved the budgeting procedures in 2015. All below the line financing items have been moved above the line: the 191 billion dinars central government deficit for 2015 now includes all the financing. Unlike previous years, the liquidity financing for public enterprises must now be stated above the line and included in the deficit.

We also want to report the full public sector. As part of the legacy of the past, we had many enterprises with unclear ownership structure: somewhere between the socially-owned, state-owned and private market companies. Based on the EU criteria, companies making less than 50% of their revenues on the market were treated as de facto public companies. Reclassifying these companies as public companies is going to hurt initially, but in the longer run these criteria should guide the government to move out of enterprises in distress or unable to survive on the market. In short, we are committed to full and transparent statistical reporting on public sector in line with the EU standards in all aspects of reporting.

The fourth comment is important as it relates to the coordination of policies between the Ministry of Finance, the Government and the National Bank of Serbia. The first staff press statement of the International Monetary Fund released on November 20, 2014, clearly

identified there is scope for trade-off between monetary and fiscal policy, as the rebalancing of the macroeconomic policies with fiscal consolidation is a precondition for more accommodating monetary policies stance. Economic growth suffered from overly tight monetary policy caused by the lack of confidence that the fiscal policy was conducted responsibly and that the fiscal deficit would be kept under control.

Over the past ten months we have improved the quality of fiscal management that confirmed with a large margin of confidence the steps that the National Bank of Serbia has taken already in relaxing the policy rate from over 9% to below 5%. We hope that this will translate into lower interest rate margins and credit growth that will create an environment conducive to investment, job creation and growth in Serbia in the coming months and years.

Regarding the business environment, as much as we were surprised by the low ranking in the previous Doing Business report 2015, we were pleased to note that even partial account of the reforms done by this government has resulted in a huge improvement in this year. Doing Business 2016 ranks Serbia 59 compared to 91st place in the previous report. A brief account of the completed reforms that have not been fully reflected in the latest report (such as getting building permits, ease of paying taxes and so forth) gives us confidence that further advances in the ranking are to be expected in the next year report.



We are doing the set of initiatives to try to lower and control the grey economy. I would call back some of the efforts of the Ministry of Finance. We managed to consistently increase revenues from excise taxes on tobacco in the past 12 months. We plan to further strengthen

this through better screening and monitoring. The reform and transformation of the Tax Administration is underway, leading to a modern robust compliance based Tax Administration System that will be following the European Union standard and best international practice and significantly increase the tax base without changing the tax rates.

We want to do a number of things to provide better incentives to private investment

- We would like to enhance the Allocation Criteria for financing of SMEs including EIB (European Investment Bank) - APEX loan for SMEs which, in my understanding did not achieve as much effects as it should have.
- And the second is, we are merging two Agencies that were dedicated to providing incentives to foreign investors. One is SIEPA (Serbian Investment and Export Promotion Agency) and the other one is Serbian Regional Development Fund. We want them to work together, we want to eliminate the overhead and have put their forces together to allocate limited resources, to provide what investors really need. Not dumb cash on them, investors supposedly should bring cash, but give them the conditions and the incentives, remove the barriers to entry the production and growth.

In conclusion, let me mention the Human capital which is the important part of ERP and critical component of Serbia's growth potential. Serbia has a lot of people with general education/knowledge but lack of specific knowledge/skills needed by foreign investors to start efficient companies and increase productivity. We would like to follow the German model of dual education with greater share of vocational training and combined school-work experience starting at an early age. This could help potential investors find and develop labor force with adequate skills and behavioral patterns as well as contribute to lowering the high unemployment rate, especially among the young and educated people.

Large presence of people aged 25-35 in that unemployment group creates huge social tensions, leads to loss of knowledge during extended unemployment, and hampers the competitiveness of the Serbian economy vis-à-vis neighboring countries and the European Union.

III. First working session: *»European economic governance – new approach«*

Wednesday, 27 May 2015



Reformed economic governance as part of the preparation for membership of the European Union

Istvan Jakab

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The presentation will broadly cover **three issues**: First, I will try to put this exercise in a **historical perspective**. Second, I will also sketch the Western Balkans experience with the previous EU economic governance structures, but also in terms of economic reforms and development, trying to substantiate the need for **strengthening economic policy making** in the enlargement countries. Finally, I will move to the core of my presentation, dealing with the recently reformed economic governance and our **assessments of the Economic Reform Programmes**.

Since the fall of the Berlin wall in 1989, in several rounds of enlargement, the EU has expanded from 12 to 28 Member States, with the joining of Croatia in 2013. The process of **EU enlargement has been a defining characteristic** of Europe's political and economic development in the last quarter of a century. It brought stability to Europe and guided the transformation of the ex-communist countries from centrally planned to market economies. **Economic convergence**, being one of the goals of the enlargement process, has been in the focus of attention for much of the period. Besides its importance in view of improving the standards of living in the converging economies, it is also often considered as a crucial element in fostering social cohesion and overall political stability.

Throughout this period, the EU has been trying to **reconcile the deepening of integration with the widening** of the union. These processes have been going on in parallel and as new mechanisms for multilateral economic surveillance were being introduced for member states, the EU has also developed its policy dialogue with the enlargement countries.

However, the economic crisis of 2008 exposed a number of weaknesses in the EU coordination and surveillance of economic policy: on the fiscal side there were **unsustainable debt developments** and detrimental **macroeconomic imbalances** were not properly addressed. The peer pressure applied was not strong enough to lead to a correction of unsound policies.

The EU reaction to these problems has been comprehensive, ranging from preparing and implementing **adjustments programmes** to creating **financial backstops**, in order to

restore access to financing for some Member States through the European Financial Stability Facility, the European Financial Stability Mechanism and the European Stability Mechanism. Because the crisis revealed gaps in the controls of operations of the financial system, reforms have been put in place to remedy the deficiencies and to ensure that the financial sector is a reliable foundation for future growth and prosperity.

The most fundamental change was the creation of a **new supervisory structure**, comprising three EU authorities with binding powers over the EU's financial sector and the creation of a European Systemic Risk Board. In addition, reforms also addressed credit rating agencies, hedge funds and private equity firms, derivatives, short selling of credit default swaps, bank levies, deposit guarantee systems and bankers' bonuses. The EU has also conducted tests on banks' ability to withstand future shocks.

With a view to crisis prevention and addressing imbalances, the EU adopted far-reaching legislation (the six and two-packs), which fundamentally reshaped economic governance in the European Union, and particularly in the euro area. Under the so-called **European semester**, new integrated economic policy surveillance is now in place, covering public finances, macroeconomic imbalances, growth and jobs and the financial sector. It provides ex-ante policy guidance to member states and pays particular attention to monitoring and implementation.

The EU has developed in parallel its multilateral economic surveillance for the candidate countries. In 2000, the Commission was invited by the Council to report annually on these countries' macroeconomic and financial stability on the basis of their reports known as **Pre-Accession Economic Programmes** (PEPs). Starting in 2006, the potential candidates were also included in a similar process, being invited to present **Economic and Fiscal Programmes** (EFPs). The Commission suggested framework was based on the Stability and Growth Pact, which entered into force at that time. It also added a part on structural reforms which have an important macroeconomic impact and requested information on the fiscal impact of those reforms. One of the important aspects of this exercise was capacity building in the enlargement countries. Since 2012, new elements were added to the programmes – the explicit assessment of external sustainability and competitiveness issues. The countries were also asked to identify the main structural bottlenecks to growth. As of last year and in line with the European semester for member states, the process was upgraded with the introduction of **policy recommendations by a joint ECOFIN Council meeting**.

The need to further strengthen economic governance becomes clearer if one looks at the transition experience of the current enlargement countries, except for Turkey. While economic convergence has been a clear success for most of the new Member States, the story is much more nuanced for the Western Balkan countries.

The economic convergence of these countries is less pronounced, owing mostly to their late inclusion in the transition process because of the wars in the 1990s. Indeed, the 90s show a diverging trend, which was reversed only in 2000. Until the beginning of the global financial crisis, the pace of income convergence was on par with that of the new members.

However, the role of private consumption was more pronounced in the Western Balkans, with significantly more negative contributions coming from net exports. **Weaker economic fundamentals** have made the region more vulnerable and, with the crisis, its economic convergence has strongly decelerated.

What is the new approach to economic governance? As of this year, the PEPs and the EFPs were replaced by **Economic Reform Programmes** (ERPs), which now consist of two clearly separated parts. **Part one** is basically a continuation of the Pre-Accession Economic Programmes and covers again the macroeconomic and fiscal framework and the main structural reforms underpinning it. **Part two** is sectoral in nature and is oriented towards reforms improving long-term growth and competitiveness. It covers sectors like: transportation, energy, labour markets, education and innovation.

Since the aim of the enlargement policy is to **help candidate countries to prepare for the European Union membership**, it is essential that we share with you the very important changes that are taking place at EU level. The strengthened economic governance would, therefore, involve a presentation of a credible reform programme and an enhanced surveillance by the European Union. Although the ERPs are inspired by the enhanced EU economic policy coordination following the crisis and sometimes we refer to them as the "**European semester light**", they are not identical. Understandably, they are not as demanding and do not create legal obligations for the enlargement countries.

However, the ERPs expose the enlargement countries to peer-pressure and serve multiple purposes – they provide a framework for domestic policy-making and a policy dialogue with the EU, which should prepare you for gradual integration into multilateral fiscal surveillance in the context of EMU. They should strengthen domestic policy co-ordination, involvement and ownership and develop institutional and analytical capacity in the pre-accession period for reporting obligations as member states. This process should also provide a signal to investors and help the countries gradually fulfil the Copenhagen economic accession criteria.

Part I is the successor of the PEPs and the EFPs. It keeps the focus on the macroeconomic and fiscal framework and the supporting structural reforms. What is new is that it includes, starting with this year, **a report on the implementation of policy recommendations** from the 2014 examination of the programmes, which was provided by the Joint ECOFIN meeting for the candidate countries and by the Commission for potential candidate countries. Looking forward, these recommendations should be used by the countries as an important tool to boost the reform process, develop a sustainable economic growth and catch-up with the EU.

Part II is the novelty of the 2015 ERPs, considered by the Commission as a pilot year in their preparation. It tries to address one major issue for all of the enlargement countries, namely: how to **improve competitiveness**? To this end, the programme looks at various sectoral reforms. It outlines measures to build physical and human capital – developing transport and energy networks, education, research and innovation. In order to promote investments, the programme should also come up with ideas to provide a better business environment,

support the dynamic SMEs, improve access to finance and cut the red tape. Trade integration should also be in focus, with measures to support exports and attract foreign direct investments.

The ERPs should be **submitted** to the Commission by the end of January. The Commission and the ECB write their **assessments** and, in the second half of April, there are **discussions** on the countries' programmes and the new set of policy guidance at the Economic and Financial Committee for Part I and the Economic Policy Committee for Part II. The joint conclusions are endorsed in May at a ministerial meeting between the EU and the candidate and potential candidate countries.

What are our main impressions from this year's round of ERPs? Overall, the **macroeconomic scenarios** are rather optimistic, with strong domestic demand pushing growth to above 4% by 2017. An exception from this pattern is Serbia, which presented a realistic macroeconomic framework, outlining the major economic constraints and challenges ahead. Public investments face fiscal constraints and private consumption is held back by difficult labour market situation across all of the countries. There is also a question mark on private investment performance, which underlines once again the importance of improving the business environment and financing conditions in order to support a rebalancing of growth.

The export base remains rather narrow across the entire region and certainly much more is needed in **attracting FDIs**, in order to successfully link to production chains and move to higher value-added and skills content products. This is very important because foreign direct investments have an important impact not only on countries' trade openness but are also a powerful source for changing economic structures and modernisation.

Over the last 25 years, the new Member States have attracted significant investments, with remarkable peaks in some of them, which helped them catch-up with the more developed EU countries. Most of the investments and trade creation took place in the period 2000-2008, but since the beginning of the crisis, FDI inflows have dropped markedly. This was also the case in the enlargement countries but, as another indication of their late transition, throughout most of the last 25 years, FDI inflows remained on average at significantly lower levels than in the new Member States. They caught up only in 2005 and could not benefit to the same extent as the new Member States from the benign international environment in the period before the crisis.

In order to be able to attract and benefit from FDIs and stimulate the badly needed domestic investments as well, the countries need first to have **sound fundamentals**. At present, for most of the Western Balkans, **fiscal consolidation** remains high on the agenda. However, the ambitious consolidation plans still need to be fully backed by **credible and specific measures** to achieve the stated goals, especially in the outer years of the programmes. This is important in view of the track record of missed targets and a history of ad-hoc decisions, in particular on the spending side. Fiscal consolidation should also increase the room for productive expenditures in human and physical capital.

The other very important element for supporting both domestic and foreign investments is the overall environment for **doing business**. There are a number of **obstacles to growth**, which are on many occasions shared across all of the enlargement countries. These include excessive state presence and direct or indirect interference in the economy. Labour market issues are prevalent as well, with low participation and high unemployment rates, especially among the youth, pointing to a general issue of education and qualifications. **Infrastructure bottlenecks**, in particular in energy and transportation, are also important impediments to growth. To alleviate this problem, the Commission is channelling significant IPA funds to improve connectivity in the region over the next programming period.

Inadequate **institutional capacity and governance issues** undermine economic performance as well and remain an overarching problem for the whole region. Governance, or the quality of institutions and reforms, is arguably linked to the pace and sustainability of real economic convergence. In the beginning of the transition period, all the countries from the former socialist block lacked the basic institutions of market economy. However, the new Member States (the countries which for the most part embraced rapid market reforms) have quickly overcome the others and – in the span of a decade – developed the foundations of a market economy. The efforts of this group of countries to reform early were vindicated in the next decade when most of them joined the EU.

However, **reforms advanced unevenly** across countries. After first quick wins in price and trade liberalisation and small scale privatization, the remaining reforms were in general more difficult and protracted, especially with regard to enterprise restructuring, large scale privatisation and competition policy. Most of the current enlargement countries (except for Albania and Turkey) have started the transition from a relatively favourable position. As part of the former Yugoslavia, these countries have already developed some form of private initiative. However, a decade of conflicts in the 1990s has led not only to economic stagnation but stalled institutional development as well. Even today, the gap between the Western Balkans and the new Member States is still significant and concerted efforts are needed to bridge it.

However, the good news is that the **reforms are paying off**. Recently, governance scores for some of the new member states have surpassed those of some 'old' member states, indicating that the division between 'old' and 'new' is probably losing its relevance. Reforms are a necessity for the enlargement countries, which indeed have results comparable to those of eastern and southern EU neighbours.

The need of reforms has been confirmed every year by the European Commission progress reports, in our Dialogues with you and in our assessments of your programmes. The reform agenda is now underpinned by the strengthened economic governance and the **country-specific targeted policy guidance**, following the Commission's assessment of your Economic Reform Programmes. The number of areas covered by these recommendations is overall impressive and should be used as a blueprint for addressing the most pressing reform needs. The Commission stands ready to help you in this process and I hope we will succeed in bringing dynamism to the Western Balkans economies.

The European Central Bank in the new economic governance framework of the European Union

Gilles Noblet

Deputy Director General for International and European Relations, ECB



In the past seven years, we have come a long way in overhauling the EU's economic governance framework. These efforts, combined with macro-economic policy adjustments and crisis management tools, have contributed to a gradual economic recovery. Despite some downside risks, we expect that the recovery will strengthen in coming months and we are optimistic that inflation will return to the ECB's target rate for price stability: an annual rate of increase of below, but close to, 2% over the medium term.

Monetary policy

Throughout the crisis, the accommodative stance of the ECB has ensured price stability and contributed to restoring smooth transmission of monetary policy.

In reaction to the crisis, the ECB gradually cut its Main Refinancing Operations (MRO) rate to unprecedented near-zero levels, from 4.25% in mid-2008 to 0.05% in September 2014. In addition, the ECB introduced a number of non-standard monetary policy measures.

A first round of non-standard measures was implemented in October 2008. At that time, the ECB switched to a fixed-rate full allotment regime in its refinancing operation. Moreover, the ECB extended the maturity of liquidity provision and expanded the list of bank assets that are eligible as collateral. These early measures were mainly targeted at allowing banks to provide sufficient and reasonably-priced financing to businesses and households in the euro area.

Later on, in a period of acute market stress between May 2010 and February 2012, the ECB introduced the Securities Markets Programme (SMP) under which it purchased government bonds on the secondary market in countries where the monetary transmission mechanism did not function properly (IT, ES, GR, PT, IE) and it conducted two longer-term refinancing operations with a maturity of three years to ensure the proper transmission of monetary policy and encourage banks to maintain credit lines.

In summer 2012, ECB President Draghi stated that the ECB would do "whatever it takes" within its mandate to preserve the euro and the ECB announced the possibility of conducting Outright Monetary Transactions (OMTs) in secondary government bond markets for countries under an adjustment programme. Although no OMTs have been conducted so far, the

programme has been instrumental in breaking the vicious circle between banks and sovereign debt that hampered an even transmission of our monetary policy across the euro area.

A more recent round of non-standard measures began in June 2014. To counter growing deflationary risks, the ECB adopted a combination of measures to provide additional monetary policy accommodation and to support lending to the real economy. In January of this year, these measures were complemented by an expanded asset purchase programme, which is meant to address the risk of a prolonged period of too low inflation. These recent measures have already contributed to an easing of financial conditions in money and bond markets and have improved inflation expectations, coming closer to the 2% target of the ECB. In the end, however, our monetary policy can only be successful if it is accompanied by complementary fiscal and structural reform policies by euro area governments.

The new responsibilities of the ECB

Looking back, the crisis has shown that the original design of EMU was incomplete and that more needed to be done to ensure that appropriate fiscal and structural reforms are undertaken. The ECB has contributed to these efforts in regular exchanges with the European Commission, in the “Troika”, and in its new supervisory capacity.

As part of the overhaul of the EU's economic governance framework, the Stability and Growth Pact was strengthened by the introduction of reinforced rules, better surveillance, and quicker enforcement. In the area of structural reforms, meanwhile, Member States agreed to establish a new procedure for monitoring and correcting macroeconomic imbalances – the Macroeconomic Imbalance Procedure (MIP).

Further, more far reaching institutional changes were proposed in the so-called Four Presidents report, which was submitted to the European Council in December 2012. From the perspective of the ECB, the most significant follow-up to this report has been the creation of a genuine banking union. The purpose of banking union is to ensure efficient supervision and restore trust in national financial systems.

In the context of banking union, the ECB now acts as the single supervisor for all banks of the euro area. In this capacity, the ECB is in charge of the direct supervision of the 120 most significant banks, representing 80 percent of the euro area banking market in asset volume. Moreover, the ECB has become responsible for the overall functioning of the Single Supervisory Mechanism (SSM). In case a bank does fail despite all efforts, the newly created Single Resolution Mechanism (SRM), backed up by a Single Resolution Fund, will ensure an orderly, fiscally neutral resolution that avoids harm to taxpayers and the real economy. We are thereby moving from 'bail out' by taxpayers to 'bail in' of investors in case of bank failures. This is a particularly important step to break the nexus between sovereigns and banks.

As a complement to banking union, the ECB also strongly supports the creation of an EU capital markets union (CMU). This initiative is aimed at better integrating national capital

markets and increasing the importance of capital markets as a source of funding for the real economy. Ultimately, CMU will improve access to funding, increase the efficiency of the financial system, and further private risk sharing.

EU enlargement and euro area accession

Aside from its core responsibility for monetary policy and supervision, the ECB also has some responsibilities in the process of EU accession and euro area enlargement. While the ECB has no formal role in the EU accession process, it is actively involved in the Brussels-based processes where surveillance of prospective EU Member States is conducted.

Upon EU accession, all new Member States are expected to follow macroeconomic policies that are consistent with the final adoption of the euro. Every two years, the ECB assesses progress and publishes a so-called Convergence Report. The purpose of this exercise is to ensure that Member States achieve a sufficient degree of economic convergence to allow adjustment mechanisms to operate smoothly.

In case of a positive assessment in the Convergence Report, the ECB and other stakeholders are invited to discuss and give opinions in the legislative process for euro adoption. Moreover, the ECB is also involved in defining the appropriate euro conversion rate of the national currency.

The situation in Serbia

Serbia currently has a unique opportunity to embark on a path of stabilisation and reform. Serbian authorities have secured a precautionary stand-by arrangement from the IMF to support them in this endeavour. The ECB is committed to play its role in this historical process, particularly with regard to the smooth integration of the NBS into the European System of Central Banks.

Putting public finances on a sustainable footing remains a key challenge. Further fiscal consolidation would afford monetary authorities greater freedom to support the real economy by reducing policy trade-offs between domestic and external objectives. Also, the restoration of the bank lending channel remains crucial. It will help fend off financial stability risks, revive economic activity, and increase the overall effectiveness of monetary policy. The 'rightsizing' of the public sector, the management of state-owned enterprises, and NPL disposal thus remain high on the agenda.

European economic governance and implications for EU candidate countries

Mojmir Mrak

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First of all, I would like to thank the National Bank Serbia and its governor Ms. Jorgovanka Tabakovic for the invitation. It is, indeed, an honour for me to participate in this high level Conference and to have an opportunity to present my views on a highly topical issue of European economic governance and implications this reformed governance has on the EU accession process. I have personal experience in this subject stemming from two sources. One dates back to the times of Slovenia's activities within the European economic governance before and after its membership in the EU and later on in the eurozone. In more recent years, I have been involved in preparation of Economic and Fiscal Programmes / Pre-accession Economic Programmes and their successor Economic Reform Programmes for several EU candidate countries in the region.

My presentation will be divided in three main parts. I will start with presentation of the European economic governance concept and its evolution prior to the crisis. In the continuation, I will address changes that happened in the European economic governance as a consequence of the recent crisis. And finally, I will focus on two main channels through which the reformed European economic governance influences the candidate countries. One channel is a broadened dialogue of a candidate country with the EU on economic policies based on Economic Reform Programme (ERP), and the other are the EU accession negotiations under Chapter 17.

I. Concept of the European economic governance and its evolution before the recent crisis

The term governance describes the overall philosophy and architecture of economic policy-making as well as of the institutions and processes that guide the evolution of the economy. The manner in which economic governance is run within the EU (EEG) is unique for several reasons. One is evolution of the European integration process from a customs union to a monetary union. Another one is a growing sense that improved economic governance is essential for the European Union to perform better. And finally, several rounds of enlargements have increased heterogeneity within the European Union and this is associated with the need for uniform rules and procedures.

Over the recent decades prior to the crisis, European economic governance had gone through different stages. In contrast to strong economic growth until mid-1970s, EU economic performance was rather poor in the decades that followed. In order to reverse this negative trend, a set of important policy initiatives was launched in mid-1980s. Two of them should be mentioned specifically.

- To strengthen economic growth, to increase productivity and to successfully address the growing unemployment problem, the Single Market Program was initiated, stronger competition policy was introduced, and global trade liberalization made a strong step forward with the successfully completed Uruguay round. All these development were later on, in the year 2000, complemented with Lisbon strategy as the first full-fledged EU strategy for strengthening its international competitiveness. Within this framework, a completely redesigned cohesion policy has to be mentioned as well.
- In the macroeconomic policy areas, the monetary union was initiated with the Maastricht Treaty in 1992, while the Stability and Growth Pact (SGP) introduced in 1997 was aimed to be its fiscal pillar.

All these adjustments in economic policies were associated with significant changes in the European economic governance. In early 2000s, the governance was characterized by the following features. On the macroeconomic policy side, monetary policy was delegated to the newly created European Central Bank, while fiscal policy was implemented through policy coordination under the SGP. In the areas of growth, productivity and employment issues, the economic governance was much more complex. While implementation of the Single Market provisions was governed through partial delegation of legislative powers to EU level, Lisbon Strategy objectives were to be achieved through vague “open method of coordination”. And finally cohesion policy, competences were shared between EU level and member states since the Delors I medium-term financial perspective.

To summarize, deepening and widening of the European Union was associated with a need for more legislation. The delegation method, as the key method of economic governance in the early decades of the European Union, was increasingly complemented with a strong body of economic policies where responsibility stayed with the member states, but they subscribed for EU surveillance or policy coordination.

In the decades prior to the crisis, European economic governance had a rather limited impact on the EU accession process of the candidate countries. As far as fiscal policy is concerned, these countries were asked to enter in the so-called “pre-accession fiscal surveillance”. It consisted of two components. The first one was a policy dialogue on medium-term policy framework (primarily on macroeconomic and fiscal issues) based on the so-called Pre-accession Economic Programmes for official candidate countries and Economic and Fiscal Programmes for potential candidate countries. The second component of the “surveillance” consisted of fiscal notifications. In contrast to the fiscal area where there was a systemically

established dialogue between a candidate country and the European Union, this was not the case for the economic growth, productivity and unemployment areas. These areas were addressed only sporadically through annual Progress Reports. And finally, a few words about the cohesion policy and EU candidate countries. Though pre-accession funds were rather limited in size, they were instrumental for the preparation of these countries for substantially larger volume of funds once they become full members. Especially important was the insistence on medium-term programming and introduction of decentralized management of funds.

As far as EU accession negotiations are concerned, European economic governance issues were considered as rather “light” and uncomplicated subject of negotiations. *Acquis* in this area was very limited and largely focused on issues associated with the central bank independence. Consequently, no transition periods were requested by the candidate countries in this area during the large Eastern enlargement negotiations.

II. Changes of the European economic governance driven by the recent crisis

The 2008 global and especially eurozone financial crisis revealed clearly that due to the design failures in its original institutional structure major changes were urgently needed in the European economic governance. Two of these inadequacies / design failures have been of particular importance.

- The first one was a failure to introduce an appropriate fiscal arm of the newly designed monetary union. As there was no appetite of EU member states to establish a full-fledged fiscal arm of the newly created monetary union at the time when the Maastricht Treaty was negotiated, a “second best solution” known as the SGP was put in place. SGP was, in fact, the key crisis prevention fiscal instrument of the eurozone. Unfortunately, it had two main deficiencies. *First*, it was based under an assumption that all eurozone member states would “keep their houses” in fiscal order with public finance deficits below 3 per cent of GDP and public debts below 60 per cent of GDP. *Second*, SGP was inadequately managed. A clear example of this problem was the 2003 weakening of the SGP by several member states including Germany which was the main SGP proponent. Making the SGP rules more flexible in 2005 was a major blow to the credibility of the eurozone's economic governance.
- The second design failure of the eurozone's institutional structure as designed in the Maastricht Treaty was a non-existence of a debt resolution mechanism. The architects of the original eurozone had namely been of an opinion that under an assumption of a good functioning of the SGP, there would be no need for establishing such a mechanism. The logic was roughly as follows. If member states would stick to the GDP rules, then it was reasonable to expect that none of members would enter into a crisis. If nobody would enter into a crisis, then there is no need to create a special debt management and resolution mechanism. The Maastricht Treaty even went a step further. Under the so-called “non bail-out” provision of this Treaty, no member of the euro area would be assisted if in a default situation.

The overall strategy for a systemic reform of the economic governance in the eurozone triggered by the crisis was conceptually aimed at putting in place an appropriate fiscal arm of the monetary union that will be robust enough to sustain the pressures experienced during the crisis. In more specific terms, this governance reform, on the one hand, has been oriented towards strengthening substantially the SGP as the euro area's key crisis prevention mechanism, and on the other hand, towards putting in place an entirely new crisis management and resolution mechanism as it was missing entirely in the original institutional infrastructure of the eurozone.

With respect to the substance of the *crisis prevention mechanism*, the reform of the SGP was focused towards broadening and widening the economic policy framework. In contrast to the pre-crisis period when the framework was narrowly focused on public finances, the area of surveillance has broadened over the recent years to overall macroeconomic coordination among the member states. With the legislative packages such as the “six pack”, the “two pack” and the Fiscal Compact, the public finance dimensions were complemented with more general macroeconomic surveillance issues. In addition, the European semester was introduced as an instrument for coordination of the member states' economic and fiscal policies.

As far as the *crisis management and resolution mechanism* is concerned, it has been mentioned already that there was no mechanism of that kind in the original institutional structure of the eurozone. It is because of this systemic deficiency that the eurozone, when faced with the Greek crisis and its contagion to other euro area members, had no alternative but to create an entirely new mechanism. At the beginning, European Financial Stability Facility was put in place as an *ad-hoc* temporary arrangement, while a permanent mechanism called European Stability Mechanism started with its formal operations in October 2012.

During the crisis, the pre-crisis European economic governance model that was rather simple and straightforward came to an end. It has namely become obvious that a sustainable monetary union, due to high level of economic dependency among the members, requires stricter rules of implementation than in case of the EU members. There is no doubt that the “six-pack”, the “two-pack”, the Fiscal Compact and the European Stability Mechanism do contain the most far-reaching legal reforms of the fiscal governance framework since the introduction of the single currency. Introduction of these legal acts has, however, contributed to a drastic transformation of the EU / euro area economic governance from a rather simple into a very complex one.

There is a number of factors why the EU / euro area governance structure has become significantly more complex during the crisis than it was before. *First*, the broadened crisis prevention legislation extends well beyond the fiscal issues covered before the crisis. *Second*, new legislation establishes a crisis resolution mechanism that did not exist before. *Third*, new European semester procedure introduces new instruments, such as Stability Reports (macro / fiscal issues) and National Reform Programs (structural reform issues). And *fourth*, new macro-economic conditionality was introduced into the area of cohesion.

Though the Community method – it is a synonym for rules-based governance with 'supranational' actors having the leading if not decisive role – has retained through the “six pack” and the “two pack” its strong role in the EU / euro area economic governance, this method is now complemented with various forms of intergovernmental method. ESM, for example, was established at the euro area level, while the Fiscal Compact was institutionalized on the *ad-hoc* intergovernmental basis and incorporates 25 EU member states. This highly complex legal response to the Europe's financial crises combining Community and intergovernmental approaches has made the decision making system and processes much more complicated and difficult.

III. Channels through which the reformed European economic governance influences the EU candidate countries

This reformed European economic governance has trickled down into the EU accession process through two main channels. One is a broadened scope for *acquis* harmonisation within Chapter 17 of the EU accession negotiations, and the other a broadened framework for consultation on economic policy coordination. Let me briefly address both of them.

In contrast to previous EU accession negotiations when *acquis* in this area was rather limited and focused largely on central bank independence, the European legal framework in this area has now broadened substantially. In addition to the banking union legislation, let me mention here specifically the required harmonisation with the package of 5 regulations and a directive known as the “six pack”. With this legislative package which entered into force in December 2011, the public finance dimensions of the legislation were complemented with more general macroeconomic surveillance issues. In future, non-fiscal imbalances and weaknesses will be addressed much more systematically, especially the ones associated with the international competitiveness of national economies and the stability of their financial sectors. As an integral part of this legislative package, the European semester was introduced as an instrument for coordination of the member states' economic and fiscal policies.

In contrast to the pre-crisis period, the *acquis* chapter on economic and monetary policy, now Chapter 17, has become much broader and covers numerous economic governance issues. Negotiations under Chapter 17 have become increasingly linked with the fulfillment of the Copenhagen economic criteria conditions *per se* for EU membership. The crisis has namely resulted in a much more detailed assessment of how candidate countries meet the economic criteria, thus this chapter has become increasingly important in the negotiations. Crucial for successful negotiations on this Chapter is good cooperation between the central bank and the ministry of finance. The role of the latter in this Chapter of the negotiations has increased significantly.

Let me now turn to the significantly broadened framework for consultation on economic policy coordination as the *second channel* through which the reformed European economic governance influences the candidate countries. While before the crisis this framework was largely focused on macro and fiscal issues, it now encompasses in a much more systemic

manner also the growth and competitiveness issues. In 2014, the candidate countries were asked for the first time to produce a document called Economic Reform Programme (ERP) which, in fact, represents a new generation of a document supporting economic policy dialogue between a candidate country and the European Union. Also, the procedure for assessing this document has been strengthened. Now, the annual process ends with the adoption of country specific recommendations at the ECOFIN meeting.

Let me elaborate a bit on the concept of the ERP document and on the experiences gathered through preparation of the first batch of these documents prepared by the candidate countries in the later part of 2014 and submitted to the European Commission in early 2015.

As far as the concept of the document is concerned, the content of ERPs, which consists of two rather independent parts, is rather similar to the combined content of the two documents – Stability Report and National Reform Programme – to be produced on an annual basis by EU member states. In terms of management of these documents on the side of the European Commission, it is the DG ECFIN that backstops the assessment of both documents produced by the member states. In contrast, management of ERPs is divided between the DG ECFIN and DG NEAR. While DG ECFIN backstops activities related to the first part of ERPs addressing macro-economic projections, fiscal programming and horizontal structural policies, DG NEAR is a backstop for the second part of ERPs focused on “sectoral structural reforms” with the explicit goal of improving competitiveness and economic growth.

Though the general intention is appropriate, i.e. to tackle in a more systematic manner the obstacles to growth and competitiveness issues by the candidate countries, actual preparation of the first year's ERPs, especially of the segments on structural reforms, was associated with numerous difficulties partly caused by weaknesses and / or inconsistencies of the EC *Guidance* for preparation of structural reform segments of the document. For example, criteria for classification of structural reforms between the two parts of the ERP were not articulated. As a consequence, certain segments of structural reforms were addressed twice, which implied duplication of tasks. There was also inconsistency between the two parts of the document with respect to quantification of fiscal effects of structural reforms. In addition, there have been some specific weaknesses in the *Guidance* for preparation of the ERP's second part focused on “sectoral structural reforms”. They include the following: the criteria for the definition of “sectoral structural reforms” are not clear and seem arbitrary, definition of a “key priority sectoral reform measure” is not clear, guidance on fiscal impact of structural reforms is inadequate.

In a document made available to the European Commission in April 2015², several suggestions were made with an objective to improve the *Guidance* for preparation of the part two of ERPs.

² Mrak, Mojmir and Šušteršič, Janez. *EC 2015 ERP Guidance on Structural Reforms: Comments and Suggestions for Improvement*. 16 April 2015

Following the example of comparable documents for the EU member states, it is suggested that the document addressing macroeconomic and fiscal projections and policies should have a single comprehensive chapter covering all structural reforms – horizontal (now in the first part) and sectoral (now in the second part). All of these reforms should be addressed consistently, i.e. using the same methodological approach and the same analytical tools. If, for whatever reason, this “first best approach” is not possible, then the quality of the structural reform segments in both parts of ERPs should be improved through consistent classification of structural reforms, clear definition of sectoral structural reforms, and harmonised templates for quantification of fiscal effects of structural reforms.



To conclude, the recent economic and financial crisis has significantly changed the European economic governance. It has become not only broader in substance, but also much more complicated in terms of its management. As EU candidates are joining this more complex European economic governance structure, this creates additional challenges for them on two fronts. *First*, the economic policy dialogue based on ERPs has become more comprehensive and structured, and *second*, in EU accession negotiations on Chapter 17, meeting the Copenhagen economic criteria has become more important than it was the case in previous rounds of EU enlargement.

IV Second working session:

»National Bank of Serbia in the EU accession negotiation«

Thursday, 28 May 2015

Experience and the role of the National Bank of Serbia in the EU accession process of the Republic of Serbia

Zoran Nišavić

General Manager of the International Relations Department in the National Bank of Serbia



Ladies and gentlemen, dear colleagues and members of the press,

Allow me to greet you at the start of the second day of the international conference “Economic Governance in Europe and EU Accession Process: What is the Role of Central Banks”.

Today's activities are devoted to the panel discussion of governors and vice governors of central banks of Montenegro, Albania, Turkey, Bosnia and Herzegovina, Macedonia, Slovenia and Serbia.

Before we start the panel, it is my great honour to say a few words before this eminent gathering about the National Bank of Serbia's role in the country's European integration process.

The Republic of Serbia filed its EU candidacy bid in December in 2009 and gained the candidate status in March 2012. Activities were stepped up particularly after the first intergovernmental conference held in January 2014, which marked the start of accession negotiations.

The National Bank of Serbia actively participates in all phases of Serbia's EU accession process.

Harmonisation of the legal and institutional framework of the National Bank of Serbia with the European System of Central Banks, international standards and practice, is the Bank's priority and a precondition for the preservation and strengthening of financial stability in Serbia.

The National Bank of Serbia has its representatives in the bodies of the Republic of Serbia which are the most relevant for the negotiation process – the Coordination Body and the Coordination Body Council. Moreover, it has confirmed its commitment to this process also by assuming the lead role under two chapters: Financial Services and Economic and Monetary Policy. Furthermore, the Bank plays a very important role in the chapter of Free Movement of Capital, where it has been designated as the second competent institution, but also in other chapters where it has its representatives: Statistics, Consumer Protection, Financial Control, Financial and Budgetary Provisions, Competition, Company Law, Freedom of Movement for Workers and Right of Establishment and Freedom to Provide Services.

I would like to emphasise that the National Bank of Serbia has given a great contribution to the successful conclusion of the screening process. Its representatives have taken part in explanatory and bilateral meetings in Brussels, and have discussed with European Commission representatives the degree of harmonisation of domestic regulations with the *acquis communautaire*.

The National Bank of Serbia's role is certainly most important in chapters 9, 17 and 4.

9 – Financial Services

The work of this negotiating group is organised around specific topics (subchapters) and subgroups for banking, insurance, stock exchanges and other securities markets, including other economic and trade provisions.

During negotiations on this chapter, a central bank has to transpose regulations of the European Union on licensing, operation and supervision of financial institutions. This concerns central banks supervising financial institutions (banks, insurance companies, voluntary pension funds).

As part of commitment to continuous improvement of the regulatory framework for banking operation, Serbia's legislation in this field was changed in February this year. Amendments to the Law on Banks were the most important among this reform set of laws. The amended Law on Banks was proposed by the National Bank of Serbia and aims at improving the bank recovery and resolution framework in accordance with principles and rules enshrined in the Bank Recovery and Resolution Directive of the European Union.

In addition, the set of adopted laws also contains provisions ensuring further harmonisation with the European Union *acquis* in the field of deposit insurance.

In regard to the implementation of Basel III standards in Serbia, in December 2013 the National Bank of Serbia's Executive Board adopted the Strategy for the introduction of these standards. According to the Strategy, all preparatory activities, including the development of draft regulations, must be implemented by late 2015. This will enable the start of implementation of European Union regulations, whereby these standards will be introduced in the short run.

The new Insurance Law, adopted among other reform laws in December 2014, ensures further harmonisation with the European Union directives in the field of insurance services, such as: Solvency I directives (life and non-life insurance and reinsurance) and the Insurance Mediation Directive (IMD). In June 2014, when giving its opinion on the draft Insurance Law, the European Commission highlighted that the Law marks a good step forward in harmonisation with European insurance rules.

17 – Economic and monetary policy

The negotiating group in this field is divided into two subgroups: monetary policy pursued by the National Bank of Serbia, and economic policy under the remit of the Ministry of Finance.

The European Union *acquis* that a candidate country must transpose during the membership negotiations within this chapter includes European Union regulations governing the independence and autonomy of the central bank as a future member of the European System of Central Banks, the obligation to pursue fiscal policy in accordance with principles and rules applied in the European Union, reporting on the balance of budget deficit and public debt, participation in multilateral supervision of public finances of European Union member states and coordination of all economic policies. Furthermore, the transposition and implementation of European Union regulations in this field disables direct public sector financing by the central bank and privileged access of the public sector to financial institutions. In the domain of fiscal policy, a future member state is expected to embrace the new concept of economic governance in the European Union and to comply with fiscal rules, notably in terms of the level of budget deficit and public debt. It must also implement corrective measures in case of tendencies towards a negative fiscal position, and must regularly inform the European Commission thereof.

Serbia has transposed the European Union *acquis* in chapter 17. After the bilateral screening in March this year, it was stated that relevant domestic regulations in this field are harmonised to a significant degree with the European Union *acquis*. It was also concluded that no major challenges are awaiting the Republic of Serbia in this regard.

4 – Free movement of capital

To be as efficient as possible, the negotiating group is divided according to the subchapters which form an integral part of the *acquis* within this chapter. These subchapters include: Movement of Capital and Current Payments, Payment Systems, and Anti-Money Laundering and Terrorism Financing.

During negotiations within this chapter, we are steadily harmonising the domestic legal framework with the European Union *acquis*, and this harmonisation involves the removal, with certain exceptions, of all restrictions on capital movement both within the European Union and between member states and third countries. This area also includes European Union regulations governing cross-border payments and rules on anti-money laundering and terrorism financing.

As we have assumed the obligation under the Stabilisation and Association Agreement (SAA) that Serbia will within four years of the entry into force of the SAA ensure free movement of capital in the area of portfolio investments and financial loans and credits with maturity of up to one year, the fulfilment of these obligations gains critical importance after the opening of membership negotiations.

Finally, the Law on Payment Services adopted in December 2014 marks full harmonisation of our national legal framework with the Directive of the European Parliament and Council on the settlement finality in payment system and securities settlement system – in part relating to the payment system, and the Directive of the European Parliament and Council on the taking up, pursuit and prudential supervision of the business of electronic money institutions,

as well as Directive of the European Parliament and Council on payment services in the internal market.

The NBS plays an important role in other chapters as well. Its representatives participate actively in the following areas:

Statistics – Under the 2009 Law on Official Statistics, the National Bank of Serbia is one of the official producers of statistics of the Republic of Serbia. As a result, within chapter 18, the National Bank of Serbia participates in negotiations concerning balance of payments statistics, FDI and international services trade statistics, statistics of foreign branches and financial account statistics.

In its bilateral screening conclusions, the European Commission commended the National Bank of Serbia for the quality of its data and timely reporting to the EUROSTAT, and highlighted that the National Bank of Serbia's balance of payments statistics is mostly aligned with European Union standards and methodology in this area.

Consumer Protection – at the proposal of the National Bank of Serbia, the Law on Amendments and Supplements to the Law on Financial Services Consumer Protection was adopted in order to ensure better protection of consumer rights, in accordance with European Union standards.

Financial Control – Within this negotiating group, the National Bank of Serbia is in charge of the protection of the euro against counterfeiting. After receiving the Screening Report from the European Commission, the National Bank of Serbia has given a significant contribution to the drafting of the Serbian negotiating position in this area. In this context, the National Bank of Serbia signed with the European Central Bank a cooperation agreement regarding the prevention and detection of euro counterfeits.

The representatives of the National Bank of Serbia give significant contribution in the work of the following negotiating chapter as well: Financial and Budgetary Provisions, Competition, Company Law, Freedom of Movement for Workers and Right of Establishment and Freedom to Provide Services.

We also participate in the work of bodies implementing the Stabilisation and Association Agreement, these being the Subcommittee for Internal Market and Protection of Competition and the Subcommittee for Economic and Financial Matters and Statistics.

Through cooperation with other institutions in our country, representatives of the National Bank of Serbia participate in the annual meetings within the Ministerial Dialogue between the European Union and candidate countries, as well as in the development of strategic documents such as the National Programme for the Adoption of the *Acquis* (NPAA) and the National Economic Reform Programme (NERP), which is particularly important for discussion at this conference.

A particularly important form of cooperation between central banks of European Union candidate countries and the European Central Bank is the so-called high level dialogue which includes annual meeting of top level officials and focuses on key economic developments, monetary policy implementation and current macroeconomic position of the countries concerned.

There is a great deal of activities and they require adequate organisation. The key word is coordination, both internal and external.

External coordination refers to communication with the European Union Integration Office, the Government, ministries, notably the Ministry of Finance, but also with other institutions of the Republic of Serbia, like the Serbian Statistical Office, and other. We have created appropriate internal coordination structures to enable efficient implementation of the said activities.

The National Bank of Serbia is ready and always forward-looking when it comes to numerous activities and obligations ahead of the central bank and the Republic of Serbia on the path to the EU. With such an approach, the National Bank of Serbia is contributing significantly to the EU accession process.

In November 2013, i.e. before the start of the accession negotiations, we set up a working body which monitors, coordinates and directs the activities of the National Bank of Serbia in this complex process. The National Bank of Serbia has clearly defined its role and position in the membership negotiations relative to other government bodies, and has formed a team of people who will participate in the negotiation process.



In order to meet successfully all the requirements and obligations stemming from the EU integration process, the National Bank of Serbia started operational preparations on time.

In this context, the National Bank of Serbia has started cooperation with the European Central Bank in 2008 and set out on a path of irreversible progress towards advanced European standards of central banking. Cooperation with the European Central Bank took the form of two EU-funded projects.

The first technical assistance project titled “Needs Analysis for the National Bank of Serbia” was implemented by the European Central Bank from September 2008 through May 2009. The project identified the gaps between the existing regulatory and operational framework of the National Bank of Serbia and standards of the European System of Central Banks. It identified areas where there is scope for improvement and on which the National Bank of Serbia must work as part of its preparations for the European System of Central Banks. The project covered six areas of National Bank of Serbia’s operation: bank supervision, harmonisation of legislation, liberalisation of capital movements, monetary and exchange rate policy implementation, statistics (monetary, financial and balance of payments) and financial services consumer protection. In addition to the European Central Bank, the project involved 17 national central banks of the European System of Central Banks.

Cooperation was continued through the IPA project “Strengthening the Institutional Capacities of the National Bank of Serbia”, in the February 2011–December 2013 period. The project involves experts of the European Central Bank and 21 national central banks of the European Union.

The project covered 13 areas of National Bank of Serbia’s operations: financial sector supervision, harmonisation of legislation, liberalisation of capital movements, foreign exchange reserve management, monetary operations, financial services consumer protection, support to the European Union accession process, economic analyses and research, statistics, payment system, financial stability, accounting and financial reporting, and information technology.

More than 170 activities were implemented within the 13 project areas and more than 25 project deliverables were achieved in the form of draft laws, strategies, gap analyses, action plans, internal guidelines, manuals and economic models, supported with a number of capacity-building activities.

The said results should enable the National Bank of Serbia to harmonise its operations with the ESCB central bank standards, to draft legislation aligned with the European Union *acquis* and to be more prepared for joining the European System of Central Banks once the Republic of Serbia meets all the requirements for a full-fledged membership in the European Union.

The National Bank of Serbia also participated in the joint technical assistance project of the European Central Bank for Western Balkan countries and Turkey, titled “Strengthening Macro- and Micro-Prudential Supervision in EU Candidates and Potential Candidates”. The project was financed from European Union funds and implemented from January 2010 to January 2012. In addition to the European Central Bank, it involved 14 national central banks of the euro area, the European Commission and a large number of partner institutions. Successful conclusion

of the project marks an important step in strengthening prudential supervision in the region, at the same time reinforcing the stability of the banking sector as an important element of sustainable economic growth.

Aware of the importance of investing in personnel and developing human resources management policy, the National Bank of Serbia implemented the IPA project “Capacity Development of Human Resources in the National Bank of Serbia” from November 2012 to June 2013, in cooperation with the German and Czech central banks. The project facilitated a higher degree of adjustment with the standards of human resources management and practice of European Union central banks.



The opening of negotiation chapters is ahead of us. We stand ready to embrace the activities awaiting us in that phase of the process.

Thank you!

I would now give the floor to Mr. Mojmir Mrak, professor at the Faculty of Economics of the University of Ljubljana who will be the moderator of our panel today.

V. Panel with Governors and Vice Governors:

*»Role of central banks in the EU integration process
and upon entering the EU«*

Thursday, 28 May 2015

Panel with Governors and Vice Governors Role of central banks in the EU integration process and upon entering the EU

Panel with Governors and Vice Governors

Moderator: Mojmir Mrak, Jean Monnet Chair Professor, Faculty of Economics, University of Ljubljana

Participants (in alphabetical order of countries and positions):

- Gent Sejko – Governor, Bank of Albania
- Milojica Dakić – Governor, Central Bank of Montenegro
- Jorgovanka Tabaković – Governor, National Bank of Serbia
- Ernadina Bajrović – Vice Governor, Central Bank of Bosnia and Herzegovina
- Maja Kadievaska Vojnović – Vice Governor, National Bank of Macedonia
- Mejra Festić – Vice Governor, Bank of Slovenia
- Turalay Kenç – Deputy Governor, Central Bank of the Republic of Turkey

Introduction to the Panel

Mojmir Mrak, Jean Monnet Chair Professor, Faculty of Economics, University of Ljubljana; Welcome to the panel, *„Role of central banks in the European integration process and upon entering the EU“*. Let me start by saying how privileged I feel to moderate this panel composed of extremely distinguished panellists. Here with us are seven governors and vice governors from the region, most of them from the pre-accession countries and one from an EU member state.

I will give a brief introduction by first presenting the objective of the panel and then introducing the panellists. The main objective of the panel is to discuss interlinkages between the European economic governance and the EU accession process in the countries of the region with special reference to the role of central banks. Who are our panellists today (in alphabetical order of countries)? To my far right is the governor of the Bank of Albania, Gent Sejko. To my far left is Ernadina Bajrović, Vice Governor of the Central Bank of Bosnia and Herzegovina. Next to her is the Vice Governor from the National Bank of Macedonia, Maja Kadijevska Vojnović. We have with us also the Governor of the Central Bank of Montenegro, Milojica Dakić. Next to me is our host, Jorgovanka Tabaković, Governor of the National Bank of Serbia. Thank you, Governor, for taking the initiative to organise this Conference. Here with us is also Vice Governor from the Bank of Slovenia, Mejra Festić, and finally, Deputy Governor from the Central Bank of the Republic of Turkey, Turalay Kenç. Thank you all for your willingness to share with us your thoughts on the panel's topic.

We will begin with introductory reflections of all governors and vice governors on the issues discussed at the Conference yesterday and today. How does the new European economic governance trickle down to the candidate countries? To what extent does the new governance influence the process of the negotiations? What is the role of central banks in these processes? I will first ask the three governors on the panel to give their reflections, and then the floor will be given to the vice governors. We will start with the Governor of the Bank of Albania.



Introductory reflections by governors and vice governors

Gent Sejko

Governor, Bank of Albania



Dear colleagues, in my opinion, this session raises four important questions which are essential to comply with requirements of the new economic governance of the EU, and necessary for good policy analysis and decision making of each central bank.

Also, the discussion today emphasises the role of the central bank in preparation for Chapter 17, but it is important to mention that additional chapters, such as those dealing with financial services, Chapter 9, or taxation, Chapter 16, are also relevant for this discussion. These chapters have a significant influence on issues such as prices, output, consumption, investment and are therefore often crucial for the central bank policy stance. A similar claim can be made in respect of Chapters 23 & 24 which deal with law enforcement and collateral execution, and Chapter 18 which deals with statistics.

The correct implementation of these chapters interacts, directly or indirectly, with the central bank's role in the implementation of monetary policy, financial stability and banking supervision and, last but not least, with its role as a statistical agency.

However, coming back to the challenges faced by central bankers, in my experience, there are two important topics deserving the most attention, and allow me to use the Bank of Albania as an example.

The first one is about the ability of the central bank to produce, analyse and forecast the current and expected economic developments that meet the requirements of the EU governance process.

During the last twenty-five years the objectives and policy instruments of the Bank of Albania have undergone significant changes. Eventually the Bank evolved into a modern institution that safeguards price and financial stability while carrying out banking supervision and other traditional central banking duties.

The Bank of Albania produces detailed analyses and forecasts for the key macro-economic indicators that are relevant to monetary policy, financial stability, monetary operations and banking supervision. The current monetary policy framework is inflation targeting, and decision making is based primarily on inflation forecasts and shock analysis scenarios.

In this respect, a substantial amount of research has been dedicated to the creation of statistics, analysis, and forecast tools which is regularly published and documented. It enables the central bank to understand and forecast not only inflation, but also additional relevant information including the fiscal sector, employment, real economic activity, foreign developments.

Putting all of this together, it is easy to understand that the Bank of Albania has the capacity to generate a significant volume of accurate analyses, forecasts and shock scenarios for almost every indicator and development in the Albanian economy. However, technical cooperation with the ECB and its member central banks would be of great help in terms of sharing experience and expertise.

The second topic I'd like to address is the coordination, cooperation and joint discussion within and outside the central bank, which is very crucial. Actually, we share with the Commission the forecasts and analyses regarding recent domestic economic developments, we conduct regular face-to-face meetings a few times per year, and most importantly, the central bank has the same level of representation as does the Ministry of Finance in the discussions regarding economic and monetary policy.

However, despite all this, there is still room for more, especially in terms of raising the level of cooperation with the ECB and other financial oversight institutions, e.g. the European Banking Authority, so please let me illustrate this through some ideas.

The central banks of candidate countries would benefit from regular participation in meetings where important changes to the legal and institutional monetary and financial infrastructure are discussed. It would be beneficial to us to be briefed on the current coordination practices of the ECB members with the EU Commission and on how the governance procedures and its framework are streamlined by the national authorities and the Commission.

The advances in research and the speed at which policy practices and tools change make it necessary to share up-to-date information on decisions taken by the ECB and the EBA.

Internal research at the Bank of Albania indicates that policy decisions made by the ECB and the EBA, in the context of the new and innovative monetary and macro-prudential policy tools, could have a significant effect on our economies. These changes and their expected effects are valuable information that should be correctly modelled and must be incorporated into our forecast models.

As a result, I believe that it is necessary for candidate countries to have a formal role in the discussions of the technical committees and an opportunity to express their views on matters important to them. These opinions will give a chance to EU authorities to become aware of the potential implications of their decision and should also provide them with the basis for future renegotiation of goals and objectives.

Last but not least, the establishment of regional technical research and policy networks to discuss the economic performance of individual countries will serve as a learning process.

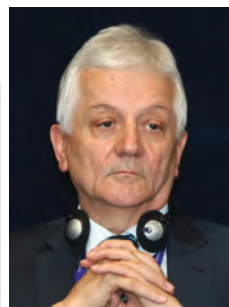
Central banks in the region should use this opportunity to cooperate frequently and share their experiences in modelling, analysis and forecasts. A regional network would help in coordinating these issues, as well as improving the process and procedures in preparation for the new EU economic governance procedures and the EU Accession process in general.

To conclude, I think that there are no major obstacles in our way, but enhancing the current conditions by adopting the best practices from the EU and international institutions, or euro area central banks, could bring additional benefits to the new economic governance process. It will help both the Commission and the central banks of candidate countries to improve communication and cooperation and produce the best outcome in terms of economic and monetary policy to achieve real convergence, stability and prosperity.

Thank you!

Milojica Dakić

Governor, Central Bank of Montenegro



I would like to express my pleasure for attending this panel today, and thank the Governor of the National Bank of Serbia, Ms. Tabaković, who invited me and whose invitation I have gladly accepted.

A full-fledged membership in the European Union is a long-term goal of Montenegro. The negotiations between the European Union and Montenegro started in the middle of 2012. So far, we have ended the screening process for 33 negotiating chapters. The EU Council adopted screening reports for these chapters prepared by the European Commission.

The Government of Montenegro has adopted Montenegro's EU Accession Programme for the 2014–2018 period. Early this year, in January 2015, the Programme was innovated, and it now represents a strategic document for the accession of Montenegro to the European Union. Also, in the middle of the last year, at the Inter-governmental Conference with Montenegro, negotiations under chapters within the direct competence of the Central Bank of Montenegro were formally opened. These are Chapter 4 – Free Movement of Capital and Chapter 32 – Financial Control.

The Central Bank of Montenegro is an active participant in the negotiation process and coordinates the drafting of negotiation positions for chapters within its direct competence.

At the moment, these are chapters 4, 9, 17 and 18. Apart from being the leading institution in negotiations on four chapters, the Central Bank of Montenegro also participates in negotiations on ten chapters in which it is not the principal body in charge. More than 40 representatives of the Central Bank of Montenegro are appointed members of these working groups. Our experience shows that the processes of EU integration and EU accession imply an active role of a large number of institutions, professionals and above all, a large number of participants from all segments of the society. All of them practically strive to achieve full harmonisation with the EU *acquis* in the process of adjustment to the European values.

This is not just about legal harmonisation, but about the achievements in other areas such as education, health, culture, technical development and other. Practically, the EU accession process penetrates all pores of our lives – legal, social, economic and political. In other words, it signifies a process of aligning the working conditions, business environment and our capacities with European standards. And for that reason, it demands thorough reforms of the society as a whole. On its path of European integration, the Central Bank of Montenegro cooperates with a large number of state institutions and bodies, but at the same time with central banks from EU member states and candidate countries. In view of this cooperation, we have very strong cooperation primarily with central banks in the region, exchanging valuable experiences. Of particular importance in this context is the fact that in this communication, especially with central banks of EU member states, we use this position so as not to repeat the mistakes that those countries were forced to make and not to waste time on them in the accession process. On the other hand, we use the technical assistance of the European Commission. To this end, I would like to remind you of the Twinning projects that we have implemented with the central bank of the Netherlands and the Bulgarian National Bank. We have also used the expert assistance from the ECB/European System of Central Banks.

Practice has shown that the integration process is a very complex long-term process that requires the adjustment of institutions and laws and all instruments and measures of economic policy, and so on. A question arises as to what is the purpose of all this? Montenegro is not taking this road to formally become a member, but to practically increase the quality of life and bring it to the European level.

I will give a short overview of certain chapters that we are dealing with at this moment. I will begin with the chapters for which the negotiation procedure has been initiated, specifically Chapter 4 – Free Movement of Capital, where the European Commission assessed that Montenegro is highly aligned and that it implements a significant part of the EU *acquis* in this area. The only remark was made regarding the implementation of the Law on National Payment Operations, where it was noted that the then applicable law was restricted only to banks and not to other possible payment service providers.

At the end of 2013, Montenegro adopted the new Law on Payment System whose implementation began on 9 January this year. In this area, 13 by-laws were adopted, which practically ensured that payments and capital movements are conducted in the same manner as in all EU member countries.

The second chapter for which negotiations were opened is Chapter 32 – Financial Control. European Commission noted that Montenegro's legal framework regarding the protection of the euro against counterfeiting is practically aligned with the *acquis*, except for the part that deals with producing medals and tokens similar to euro coins. There were no serious remarks about any other issues relating to the necessary administrative structure, or adequacy of the capacity to conduct technical analyses. Montenegro adopted a decision on medals and tokens similar to the euro, which secured the best possible implementation of European practice in Montenegro.

I will only briefly mention other chapters for which the negotiations have not yet been opened. I will begin with Chapter 17 – Economic and Monetary Policy, which is the most significant one for us. Here, the European Commission noted that the Central Bank is not sufficiently prepared for the beginning of negotiations and that this Chapter should be opened for negotiations upon the fulfilment of two conditions, namely: amending the Decision on required reserves and determining the deadline for achieving the ESA 2010 standards. Montenegro began its preparations with a comprehensive Action Plan which was submitted to the European Commission. In this regard, it also adopted a Decision on required reserves, which envisages that required reserves are lowered successively in the coming period. The possibility of allocating required reserves for investing in treasury bills is diminished. Besides that, Montenegro adopted the 2015-2017 National Economic Reform Programme, as well as the Strategy for transmission of the public debt to the accrued accounting and Strategy for the implementation of ESA 2010 in the statistics of public finances. The highlighted issue in the part relating to monetary policy is the independence of the central bank in its full sense. What follows up to the EU accession is for the Central Bank to secure prohibition of privileged access of the public sector to financial institutions. As far as the specificity of Montenegro is concerned, namely the use of the euro, negotiations on this issue will intensify once Montenegro joins the European Union.

Montenegro has achieved a high level of alignment in the area of Chapter 9 – Financial Services, but further efforts are needed when it comes to the preparation of the Law on Banks, Law on Bankruptcy and Liquidation of Banks, amendments to the Law on Deposit Insurance, as well as the Law on Additional Supervision of Financial Conglomerates. The EU Council adopted the Report on opening of this Chapter without opening benchmarks. Montenegro adopted the Draft negotiating position, which is currently in the internal procedure of the Council of Europe.

And the last issue to be mentioned in relation to this part is the statistics. In the coming period, this is the area in which activities will be most intense. I would like to focus on the issues relating to the balance of payments. Here also, a note was taken of the methodological worsening in the preparation of quarterly data on balance of payments per country and in the part relating to foreign direct investment. European Commission also noted that due note should be taken of the data on GDP, GNI, ESO standards and that through the Law on Statistics, the competence for excessive deficit should be taken over from the Ministry of Finance.

In any case, a lot has been done and there is a lot more to be done in the period ahead.

Jorgovanka Tabaković

Governor, National Bank of Serbia



It is perhaps the case of Serbia that best illustrates the change in the central bank's role in the EU accession processes of a country. We have mostly observed and analysed the experience of the Croatian central bank and its more prominent role and participation in this process, unlike central banks of other countries that were slightly less active, since they were accessing the EU in different circumstances. In Serbia, these activities are really intensive and specific, which is mainly due to two reasons. The first one is the more specific and significant role that the European Central Bank now plays in the European Union in general, and the second was fostered by the crisis itself.

How is this specificity manifested in Serbia? Though we have still not opened any of the negotiating chapters, the National Bank of Serbia has already signed an agreement with the European Central Bank. The agreement relates to the protection of the euro against counterfeiting in regard to which we have very intensive cooperation to our mutual satisfaction. This in particular shows the specificity of central banks' role in the accession process.

What is the absurdity that central banks face in this process and what difficulties they have to overcome? To preserve their independence, both institutional and functional. To preserve their conservative stance, of which we all, as central bankers, are so proud. The conservative view, the conservative hierarchy, but enabling at the same time predictability in this process, and on the other hand, responding to the dynamic change that requires us to adapt almost on a daily basis.

My short exposé will, therefore be more general than that of Mr. Dakić and I will remind you of the fact that the eurozone, with 19 member countries and a population of 330 million, has a unique institutional framework in which a single monetary policy is conducted by the European Central Bank. In that sense we are one step ahead of all other institutions in our country which is firmly and undoubtedly oriented towards the EU accession. However, fiscal and other economic policies are mostly within the competence of member states. In such a framework, vulnerability of one member state can truly endanger the functionality of the eurozone as a whole. Hence, we may dispute all other things but the economic development – in general, development and peace are the two achievements to which we all must

contribute, from any geographical continent or political level, can object. The European Union is a true guiding star in this sense.

This is why in the European Union legislation a requirement has been set that all member states, and we, candidate countries as well, should treat our economic and fiscal policies as a matter of common interest. Speaking of the topic of our Conference, the new economic governance and the role of the central banks, the aim is to identify in due course, prevent and correct problematic economic trends that may jeopardise the macroeconomic stability.

When we speak about the level of public debt or budget deficit, I would say that speaking in general terms is not enough. We must speak about the level of public debt and budget deficit in the context of the way the debt is calculated, the way it is structured, we must speak about its causes and sustainability.

I will not speak further in general terms, except that I will ask Mr. Mrak to allow me to repeat his yesterday's suggestion in the presence of the esteemed Mr. Istvan Jakab to whom I'm very grateful for being with us. It is the recommendation on how to improve "EC guidance on part two of ERPs". According to the suggestion of Mr. Mrak "first best approach" would be to have in ERP one comprehensive chapter on all structural reforms and using the same methodological approach / tools for each of them. If this is not possible for whatever reason, then 'second best approach' should be applied whereby the quality of structural reform segments (in both parts of ERPs) should be improved through (i) consistent classification of structural reforms and clear definition of sectoral structural reforms, and (ii) harmonized templates for quantification of fiscal effects of structural reforms".

Finally, I would like to add something because it would be a sin to forget how great was the contribution of the European Central Bank in the preparation of the IPA project of which Mr. Nišavić spoke. When we ended this IPA project by a joint meeting in the middle of December, a member of the ECB Executive Board was present, Mr. Jorg Asmussen, who learned while in Serbia that he was appointed a member of the German Government. We were very happy to hear about the development of his personal career, but at the same time saddened because we have lost an extremely valuable associate and a man who supported us in this project. We have not lost the support however and we expect, with Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) and all the others that this support will continue to be as wholehearted as it has been so far.

Ernadina Bajrović

Vice Governor, Central Bank of Bosnia and Herzegovina



Ladies and gentlemen, dear guests and colleagues from the National Bank of Serbia, I wish, like other colleagues, to thank, on behalf of the Central Bank of Bosnia and Herzegovina, the Governor of the National Bank of Serbia, Ms. Jorgovanka Tabaković, for the invitation, which we gladly accepted. And I must say, when last week, the governor put this invitation on my desk, I wondered 'How did they know that this is exactly what we need right now?'

In fact, after hibernating for 7 years, Bosnia and Herzegovina has finally initiated the Stabilisation and Association Process. The Stabilisation and Association Agreement will enter into force on 1 June 2015. And that is when all these activities that the colleagues have gone through or are going through at the moment will begin.

Just a brief introduction about where Bosnia and Herzegovina currently is. Bosnia and Herzegovina is a potential candidate country, which means – a candidate to be a candidate. So, sometimes it is very frustrating to be in this potential candidate status. As I said in the introduction, we have been in that status for 7 years. In June 2008 we actually started the Stabilisation and Association Agreement process and since then, nothing has happened. I could say that this was for two reasons. One is internal problem of a very, very complicated political structure. Another is the problem in the EU. They have their own problems and I believe they forgot about us. For years, since the crisis which started in 2008, they were dealing with their internal issues thinking how to resolve the crisis, how to prevent future crises, how to develop early warning indicators, and so on.

The year 2014 was very difficult for Bosnia and Herzegovina, but also for Serbia and the region as a whole. It all started with the floods that severely jeopardised the economic situation in the country. We ended 2014 with the growth of just slightly above zero. We are recovering now. There were social demonstrations, and in October we had elections. So, I strongly believe that the end of that year was also the end of the bad times.

The year 2015 started with very encouraging developments. Bosnia and Herzegovina Presidency signed an agreement with a strong commitment to start reforms and the European integration process. It is also encouraging that the other side and that means the international community – international financial institutions, European Commission and the EU delegation in Bosnia and Herzegovina – finally joined their forces. In the past, they were all

somehow present in the country, they all were addressing similar issues and proposing similar structural reforms, but they did not communicate well among themselves. So we were often focusing on some maybe less relevant issues, trying to fulfil some criteria, and forgetting about the crucial economic topics. Recently, they all joined forces under the leadership of the EU delegation in Bosnia and Herzegovina. In May this year, they met with our government – the Central Bank was invited as well – to open a dialogue on a comprehensive set of reforms. The ambitious reform agenda is expected to be published in June with each of the stakeholders expected to cover certain parts of the story.

The IMF will cover the new Banking Law and NPL resolution. Similarly to all other countries in the region, Bosnia and Herzegovina has a problem in this area. Banking resolution framework is another topic to be tackled. The World Bank is expected to address issues reflected in poor Doing Business indicators with an ambition to catch up with Macedonia that is really high on this ranking. EBRD is expected to focus on the restructuring of the companies that did not finish the privatisation process yet. They will look at some good examples in Serbia that has gone through this process. We will have to change the Labour Law. It will be a very painful reform, but it will be easier for us to implement when we look at the experiences of Croatia and Serbia. We are the last in the line undergoing this process. In this context, it is useful to remind ourselves of what our previous governor said: “It’s not that bad to be the last one in the line, because you can see the mistakes of others that can be avoided”. So, maybe we will be able to do the reforms faster. By all means, reforms in other countries in the region are really important.

Let me now move more closely to the central bank activities. The status of the Central bank the Bosnia and Herzegovina reflects a very complex environment of the country. The bank was established in 1997 as part of the Dayton Peace Accord and the Constitution made at that time. At the time of the negotiations setting the institutional framework, the parties sitting at the table were not thinking sufficiently about some important real life economic issues. For example, they have left the country’s banking system and the capital market divided in the country on the entity level, so we still do not have a single economic space in the country. The only institution of the monetary, financial, economic system that is on the state level is the Central Bank of Bosnia and Herzegovina.

So, we function as the currency board arrangement in charge of monetary policy for the entire territory of the Bosnia and Herzegovina and in charge of issuing the country's currency. Our role is to maintain monetary stability, and as of recently, financial stability as well. With respect to the latter, we are constrained by the limited role the monetary policy may play within very rigid currency board limitations. Furthermore, we have to operate within highly fragmented economic space and banking system in the country. Being in charge of the financial stability in the country, we chair the Standing Committee for Financial Stability which tries to gather information coming from different sides and to analyse it in a consistent manner. We see this role of the Central Bank of Bosnia and Herzegovina as a basis for an important role this institution will need to have in the process of EU accession negotiations. This will be necessary,

having in mind a highly fragmented economic and political situation the country. As far as monetary policy is concerned, there is an overall consensus that the currency board model should be preserved in the challenging external and internal environment. The arrangement also has large public support and confidence of the population.

Over the years, the Central Bank of Bosnia and Herzegovina has participated in a large number of projects. In 2010, we completed a project with the ECB aimed at preparation of the institution for the European integration process. We also had several IPA projects with objectives to increase the standard of operations and strengthen capacity of the institution in accordance with the standards in central banks of the ESCB system members.

In 2010, we prepared the Road Map outlining the central bank's strategy in the EU accession negotiation process, but the project was stopped. Because the state didn't go ahead with EU integration, we were not able to move forward. Now, when this process is being revived, we have to refresh our strategy, we have to see what our colleagues are doing and we can learn from their experience. The Governor of Montenegro explained that their central bank is getting involved in more and more negotiating chapters. The recent crisis also tells us that we have to be involved and that we need information on all those fields that affect financial stability and the stability of the system as a whole. We, as central banks have to be involved. Even more so in Bosnia and Herzegovina, where there is no other institution on the state level dealing with the financial system of the country.

The Central Bank of Bosnia and Herzegovina is expected to start updating the above mentioned Road Map, and within this context we will probably need some technical assistance from more experienced central banks. We are also looking very closely into what our colleagues in the National Bank of Croatia are doing. We have been receiving significant assistance from them, and it's very important to learn from them that years of preparation are needed to get into the ESCB. For 7 years they were preparing statistics and once they joined the EU, they realised they were not prepared enough. So it's really challenging. One area that is particularly challenging is statistics. We need to prepare our staff not only to have the professional skills in statistics but also the skills for negotiations and presentation. It takes time to prepare the resources to be able to participate actively in these processes. I heard the Governor of the Central Bank of Montenegro saying that according to the European Commission the bank is still not prepared for opening the negotiations under Chapter 17. I also heard the colleague from the National Bank of Serbia explaining that coordination is of the crucial importance. I learned a lot in one day not only about how the NBS coordinates activities internally, but also how important its external coordination is, i.e. coordination with other institutions. Due to specific institutional environment in the country, it is reasonable to expect that the Central Bank of Bosnia and Herzegovina will have to become the central coordination point in the country's EU accession negotiations, not only for issues under Chapter 17, but also in the areas of statistics, financial sector and capital market.

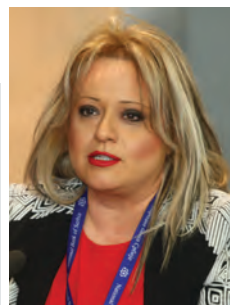
We strongly support the kind of cooperation initiated at this Conference. We are strongly of the opinion that regional cooperation is crucial, and the modalities of how central banks

cooperate in the region could really be an excellent blueprint for cooperation in the region. As you all know very well, we do not compete among ourselves. We do cooperate as we all have the same goal and this is to provide stability to the system as a whole. And as Governor Tabaković says “If one unit is having a problem, it is affecting all the others.”

At the very end, I would like to thank the National Bank of Serbia again for organising this event with the subject that I have not had a chance to participate in the previous years. We in the Central Bank of Bosnia and Herzegovina are open for further discussions on this subject and would be willing to consider hosting a similar event in Sarajevo, maybe even before the end of this year.

Maja Kadiavska Vojnović

Vice Governor, National Bank of Macedonia



First of all thank you, Governor Tabaković, for the invitation. I feel very welcome every time I come to Belgrade, especially because of you, and also because of other friends from the past. In this audience, there are many colleagues of mine from your central bank. We used to have seminars together and now we cooperate a lot.

All of us speak English. That means that we like the common language of the EU. The strong presence of high officials at this Conference attests to our joint aspiration to become a part of the EU some day, and some day, also a part of the ESCB.

Vice Governor Nina (Ms. Ernadina Bajrović, Vice Governor of the Central Bank of Bosnia and Herzegovina) was very “refreshing” with her view on the EU accession. Bosnia and Herzegovina has been a potential candidate country for 7 years. Macedonia has been a candidate country for 10 years and, in addition to this, we have been given 6 consecutive recommendations for starting of the EU accession negotiations. We didn’t fail on the economic governance criteria and we have been evaluated by international authorities, including the European Commission, as the best reformer and a country with the highest growth rate in the region. In spite of these positive economic developments, we are blocked

on our EU accession path. We have problems in other areas, the biggest one with one of our neighbours.

Being here, I'm very happy for Serbia and Montenegro that have already started the EU accession negotiations. At the same time, I am very sad. If I look at the second part of my country's Economic Reform Programme, I can see that most of the reforms are in place. These reforms are well in line with the Europe 2020 strategy which addresses structural weaknesses of European economies, aims at promoting sustainable growth accompanied with job creation, and deals with certain long-term issues, such as globalisation, aging of the population and pressures from natural resources. In our ERP, many of these issues are addressed too. We do have some results in labour market reforms leading towards lower unemployment. This is not only due to active labour market policies which probably have a short-term effect, but also because of long-term structural reforms. In recent years, we have succeeded in attracting a lot of FDIs in the tradable sector. So, we are no longer faced with the problems of narrow export base. We have achieved huge export diversification, not only in terms of the products, but also in terms of geography. This has been positively reflected in our trade balance. As a consequence, our current account deficit fell and is now at the lowest level in the region.

These developments in the external sector are helpful for our monetary policy. Mario Draghi, the ECB President said in Sintra, Portugal – I will quote this to illustrate how structural policies are relevant for monetary policy and consequently why the second part of ERP is so important. He said the following: *“Structural and cyclical policies, including monetary policy, are heavily interdependent. Structural reforms increase both the potential output and the resilience of the economy to shocks. This makes structural reforms relevant for any central bank, but especially in the monetary union context.”* I fully agree with this statement. I also share the opinion that ERP as a new type of document – it contains the first part which is continuation of the previous PEP, and the second part which addresses structural reforms. As such, it represents a good umbrella document for all relevant issues that one country should deal with.

With respect to monetary policy, it is very important for the central bank to know what the government is planning to do over the mid-term horizon. Governor Tabaković was talking about fiscal issues. Yes, this is very important for each of the countries in the region, even for Slovenia and Croatia as EU members. Many of the countries struggle with high deficits and public debt burden. As central bankers, we should know what fiscal strategy the government will follow in the mid-term and also what kind of supply side policy measures it will use to boost the potential of the economy. All of this is needed to allow us, central bankers, to make place for an accommodative monetary policy.

In the Republic of Macedonia, we have had that for many years because there was fiscal space. The government should pursue some consolidation, but still public debt is at 45% of GDP indicating that, in broader context, this is not a huge burden. On the other hand, we in the central bank have been pursuing the exchange rate targeting strategy as the core of our

monetary policy as it fits well to our economy. Positive developments in the external sector are extremely important for us as they help us to stay on the very expansive side of the monetary policy.

Once again, thank you for the invitation and for this regional overview of the processes that are the main topic of the Conference. I will not say much what is the NBRM role in the EU accession process. What I can say is that with 10 years being a country with candidate status we are very well prepared, not only institutionally, but also in terms of our knowledge. In the gap analysis with the ECB, we were evaluated as a very competent institution capable of dealing with the full process.



Mejra Festić

Vice Governor, Bank of Slovenia



Esteemed Governor of the National Bank of Serbia, esteemed professor Mrak, esteemed governors, vice governors, ladies and gentlemen, Slovenia entered the European Union in 2004. The Ministry of Finance led the activities. The central bank played a role was in the preparation of analyses, quantification of macroeconomic indicators and their implications. Then, on 1 January 2007, Slovenia introduced the euro.

I want to point out that we must never relax. We need to monitor carefully all the steps, developments, reforms, at the same pace as we did in the period prior to the EU accession and prior to the introduction of the euro.

And now I will speak about non-standard instruments and the specificity of the crisis in the period 2005–2008 in Slovenia. Maybe it's the sort of lesson to be learned by other countries that are also considering the introduction of the euro upon entering the European Union.

Slovenia entered the crisis with some specificities related to the corporate sector. The corporate sector had and still has an inter-related ownership structure which is one of the characteristics that needs to be taken into account when assessing systemic risk. Another specificity of Slovenia was the growth model of its economy in the years prior to the crisis. Decoupling of the real and financial cycle associated with debt-financed growth had proved to be unsustainable in the years of over-heating. In 2007–2008, the loan to deposit ratio of commercial banks increased to as high as 162%. This meant that the banking sector had a very high concentration of maturities of liabilities to the wholesale market reflecting too fast credit growth in a short time span. Taking into account the already mentioned specificity of inter-related ownership structure of the corporate sector, the privatisation model and the Privatisation Law were the main triggers that contributed to the prolongation of the crisis.

In October 2008, the ECB introduced non-standard monetary policy instruments, but all these non-standard measures including (very long, targeted) long-term refinancing operations, cover bond repurchasing programme, securities market programme, asset-backed securities purchase, public sector purchasing programme, expanded asset purchasing programmes, did not contribute to the desired effects in the sense of transmission of liquidity from commercial banks to the corporate sector. The non-standard monetary policy instruments were motivated by the need to ensure continued effectiveness of the monetary policy

transmission in an environment where the financial system was subject to considerable stress. Why? Where is the reason for that in Slovenia?

First, long-term refinancing operations as non-standard measures were in the majority of cases used for the repayment of the liabilities of commercial banks to the wholesale market. There was practically very limited transmission of this liquidity to the private sector. Second, a high share of non-performing loans in the banking sector has decreased after the transfer of the bad banking claims to the bad bank (BAMC). However, the economic growth remained low and it was not supported by credit growth. We have to point out again that we can talk about the growth model that is credit-less but not funding-less. There was enough liquidity after starting with non-standard monetary policy instruments in the banking system. And third, a very high leverage ratio of the corporate sector – in the beginning of the crisis the average leverage ratio was above 130% and then declined to 119%. It now stands at 112%. This means that the liability structure of the corporate sector is not in a position to accept new credits of commercial banks. Either that or the banks are not willing to lend. Given that banks are risk averse and faced with low-yield alternative assets, there is no guarantee that they will be willing to sell bonds at all. In Slovenia, there is an increased recourse of private sector to funding from abroad: the share of foreign held securities in total liabilities of the corporate sector reached 1.6% in 2014 compared to 2008, when it was 0.6%.

So, where is the answer? Why is there not enough credit growth for the corporate sector? First, some parts of the corporate sector are still suffering from debt overhang. Second, the corporate sector is still deleveraging. Third, better clients are able to tap alternative sources of financing abroad, by borrowing loans or issuing bonds.

Related to the issue of the public sector purchasing programme which started in April this year, there is limited willingness of commercial banks to sell Slovenian bonds due to excess liquidity, lack of available alternative investments, low yield environment, risk aversion of banks and negative yields on alternative assets.

Why additional non-standard monetary policy measures may not be effective in Slovenia? Related to the issue of asset-backed securities, practically we can say that in Slovenia there is not enough available assets to be included into asset-backed securities pool, so we can practically say that asset-backed securities/covered bonds do not exist owing to small amounts of underlying assets. Then, we can say that there is not enough diversification of risks by means of securitisation, because the pool of underlying assets that can be securitised is small. And finally, banks are losing the best clients which are capable of getting additional credits abroad and these problems are magnified as they may not have sufficient volume of eligible assets.

How to overcome all these disadvantages and specificities of the Slovenian economy? In order to enable durable fiscal consolidation, we need restructuring of the corporate sector. There are three segments of this restructuring. One is business restructuring which is essential, not just financial and ownership restructuring. The second segment of restructuring involves better

governance of the corporate sector. And finally, ownership responsibility has to be strengthened. If you are a responsible owner, you have to focus on the core business of the company and innovations.

There are, of course, other reforms that are needed to boost the longer term potential of the economy. At this moment, the range of the central bank activities is marked by a shift from exogenous determination of the balance sheet to its active use in pursuing medium-term objective of monetary policy. We can use non-standard monetary policy instruments in a shorter time span because the main goal of the central bank is obvious price stability. The central bank should ensure enough liquidity for commercial banks and the role of commercial banks is to support the corporate sector. But the growth model must be sustainable. If the growth model is not sustainable, a country can realise growth in the medium term, but in the long run, the companies become incapable of repaying loans. If we include the fact that ownership is irresponsible, then the company does not have enough innovation, does not have a clear business model, and sooner or later it becomes incapable of repaying the credits taken.

But I must say that Slovenia passed all these critical years and that economic forecasts for Slovenia are good. A very good indicator of the deleveraging of all segments of the economy is also the surplus in the current account that measured 6.2% last year and is estimated to reach around 5% of GDP this year. This is a very good signal and means that the economy is capable of creating additional accumulation. However, we need a mechanism to transfer this accumulation into investment projects of the real sector.

Turalay Kenç

Deputy Governor, Central Bank of the Republic of Turkey



First of all I would like to congratulate Governor Tabaković for organising this successful and very timely event, and for choosing an excellent topic for discussion. And I would also like to thank for the kind invitation.

To put the discussion into a better perspective, first, I am going to make general points about the new European economic governance. There are three points worth making about this topic. The first has been already mentioned by other panellists Prof. Mrak, Governor Tabaković, and Vice Governor Kadievskaja Vojnović, and this is the structural reform. There are two ways of strengthening the resilience of an economy against financial and economic shocks. One of them is to have a resilient financial system together with a set of prudential rules, effective

upervision and countercyclical regulations. The other one is structural reform that is going to lift the potential growth of the economy. Both are very important. The G20 agendas in the wake of the global financial crisis of 2008-2009 underscore the significance of these shock observers. Right after the crisis, the G20 meetings prioritized stimulating the global growth and devising a comprehensive financial regulatory framework leading to a resilient global financial system. Once this job was completed, G20 member countries adopted a more positive agenda along the lines of structural reforms to lift potential growth. In 2014 during the Australian G20 Presidency the G20 was committed to developing comprehensive growth strategies to support strong, sustainable and balanced global economic growth and job creation. The G20's comprehensive growth strategies are intended to lift collective GDP by more than 2 percent above the then current trajectory over five years. It was a very positive agenda with a very clear objective. The Turkish G20 Presidency complemented this structural reform agenda by tackling global investment and infrastructure shortfalls. In February 2015, the G20 made the commitment of boosting investment in G20 countries via concrete and ambitious investment strategies. G20 member states will adopt concrete country-specific investment strategies to improve the investment ecosystem, foster efficient infrastructure investment and support sound long-term financing opportunities for businesses including SMEs. International organisations – the IMF, the OECD and the WBG – developed an approach to assess structural policy commitments of individual countries quantitatively. They initially assessed the draft growth strategies to include around 1000 individual structural policy commitments. Their initial estimate suggested that the measures in the comprehensive growth strategies submitted would raise G-20 GDP by roughly 2.1 percent by 2018 if fully implemented.

I think that a similar agenda with a clear governance and communication strategy should be adopted by the EU. In a recent speech, Mario Draghi, the President of the ECB, stressed the significance of structural reforms for the euro area by highlighting that these policies alter permanently and positively the supply-side of the economy. He mentioned the two key effects of structural reforms: (i) lifting the path of potential output and (ii) making economies more resilient to economic shocks. Most importantly, he highlighted that stronger common governance of structural reforms is essential to ensure that structural reforms succeed. In this respect, the state of EU candidate countries is worth noting. Over the last 10–20 years they implemented what is called the first generation of structural reforms which involved privatizing state-owned enterprises, granting more independence to central banks and similar institutions, and achieving fiscal discipline. EU candidate countries successfully implemented this sort of reforms as they do not have significant fiscal implications and do not impose adverse changes onto private sectors. But in this regard when it comes to the implementation of the second generation of structural reforms – those implying greater and efficient use of production inputs – they are quite difficult to implement as they have fiscal implications and impose greater changes in the real economy and other areas.

For example, policies boosting innovation, improving education system and widening infrastructure will cost money and lead to structural shifts in the economy. But they are

essential for lifting the potential growth of candidate countries.

The second point is related to changes in the macroeconomic policy framework in the aftermath of the global financial crisis. The crisis led most countries to adopt a new objective – financial stability – on top of price stability and maximum employment objectives and also a new policy tool – macroprudential measures. Coordination between macroprudential regulation and macroeconomic policies poses challenges to most countries as they still explore to find an optimal mix of these policies and a better institutional design for an effective coordination and implementation of macroprudential measures. In this respect, a Union level body called the European Systemic Risk Board (ESRB) has been established in the EU with a mandate to oversee risk in the financial system as a whole. The ESRB is part of the European System of Financial Supervision (ESFS), the purpose of which is to ensure supervision of the Union's financial system. Besides the ESRB, the ESFS comprises several Union level authorities. At country level, however, I see significant differences in institutional frameworks to coordinate and implement macroprudential policies. On the one extreme, the United Kingdom adopted a financial stability framework in which the Bank of England is mostly in charge of achieving financial stability, whereas on the other extreme, in Germany, financial stability decisions are taken by the Financial Stability Committee. Such institutional country-specific differences highlight the need for stronger common governance on financial stability within the Union and across the region.

My last point is related to better communication of governance. There are situations where better communication steers outcomes to good ones. In this respect there is a simple communication problem which is directly related to this crowd. The EU has recently changed the term EU candidate countries to the term Western Balkans and Turkey. This new term sounds as if it is referring to the regional policy of the EU rather than referring to EU membership status. A careful communication of the intended policy changes is the key to gaining the support of the wider public. In this regard, a better wording would make the life easy for candidate countries to sell the story to their domestic public.

Let me give you one example highlighting the importance of communication. When Turkey had the financial crisis in 2001, the resulting IMF programme imposed a significant fiscal objective of 6.5% primary surplus. This policy condition was well communicated to the Turkish public so that the people on the street were aware that Turkey had to achieve a primary budget surplus of 6.5%. With this clear and careful communication, Turkey secured public support for the IMF programme and hence was able to achieve fiscal discipline. More importantly, this carried into the future and helped Turkey maintain primary surpluses. Even these years, it's in the region of 1-2% of GDP. Finally, the New Economic Governance of the EU should be communicated well and its communication should also aim at wider public in all countries concerned. This will increase the likelihood of success of the New Economic Governance of the EU.

Discussion by the panellists and their concluding words

Maja Kadievska Vojnović, Vice Governor, National Bank of Macedonia; This Conference is a very good opportunity to share experience on a topic of common interest and it should become a practice that countries in the region cooperate intensively on this kind of topics. The Vienna Initiative was a very good and positive example of regional cooperation. It stopped the process of deleveraging. I am confident that the power of the region as a whole will increase if we strengthen our cooperation, also through this kind of conferences, on issues of common interest.

Ernadina Bajrović, Vice Governor, Central Bank of Bosnia and Herzegovina; Listening to the debate today, it has become obvious to me why the role of central banks in the entire process is growing. Economic governance is no longer a concept focused on the fiscal side of the story with a minor role of the central bank. So my question is how do I explain back home where the line between the formal mandate of the central bank and its growing role in the economic governance process is?

In our law, the formal mandate is limited to monetary stability and currency stability. It does not include financial stability. And this deficiency has been revealed by the crisis. So, it will probably be a question among our institutions what should the formal mandate of the central bank include in future and why suddenly the growing role of the central bank is needed in the entire process.

There is another thing we will have to upgrade. We need to improve our forecasting models. Due to limitations in our monetary policy we need to be as forward-looking as possible to prevent risks in an environment where you do not have effective instruments to deal with the crises. So a lot is to be done obviously, a lot of structural reforms that the other institutions will be doing, and the central bank will be monitoring or participating in. Within this context, there is a lot of room to learn from the experience of colleagues sitting here. Therefore once again, we welcome this type of exchange of views and ideas.

Turalay Kenç, Deputy Governor, Central Bank of the Republic of Turkey; I'd like to make a point about the format of the ECOFIN Council meetings. Every year the EU candidate countries are invited for dialogue meetings between the economic and finance ministers of

the EU and the candidate countries to discuss the latest economic and financial developments in candidate countries. Unfortunately, the candidate countries don't get much time for a high-level policy dialogue at ECOFIN meetings and I understand that the ECOFIN is working on it and trying to increase the time for high level dialogues. This is quite useful and a welcome development. My personal experience over the last three years is that you don't get much time for a dialogue on the policies and recommendations stated in the documents.

Related to this, there is an awkward situation with the involvement of the ECB in these dialogue meetings. Among central bankers there is a gentlemen's agreement not to make critical statements about their respective policies (i.e. monetary policy) in public. But at the ECOFIN meetings you find that the ECB does make statements about monetary policies in candidate countries. There may be ways of making it constructive. For example, the ECB can say more about the outcomes of the monetary policies implemented by the candidate countries' central banks and less about their frameworks and policy recommendations.

Milojica Dakić, Governor, Central Bank of Montenegro; I would just like to mention that in the previous year, we as the central bank have had high-level dialogue with the European Central Bank, which is their practice with central banks of candidate countries. The result of the dialogue was a project that lasted for 7 months and that ended in March this year. It involved the assessment of harmonisation of the work of the Central Bank with the standards of the European System of Central Banks. It was conducted by the European Central Bank in cooperation with experts from 10 national central banks of EU member countries. A report was prepared containing certain recommendations that are mainly of a long-term orientation, a smaller number is medium-term oriented and very few are short-term oriented. The Central Bank has prepared an Action Plan for the implementation of these recommendations. I would like to use this opportunity to stress once again and confirm my assurance that the regional cooperation of central banks is at a really high level and this is confirmed by today's forum. In our policies for each year, and therefore for this year as well, we, as the Central Bank of Montenegro, consider the cooperation with regional central banks as one of the priorities. This is something that we will nurture in the period ahead. Besides, we always gladly accept invitations to events such as this one.

Gent Sejko, Governor, Bank of Albania; Very interesting insights and comments are a valuable outcome of the meetings of this kind. We evaluate where we are ourselves compared to the central banks of the region and we basically see that there are similarities in our concerns on the way to the European Union.

We face many dilemmas because we live in a difficult economic environment. We are affected by the crisis. Within this context, we are faced with the challenges of growth and we central banks have to deal with these challenges on the monetary policy side. Very good comments were made by several colleagues on monetary policy in their respective countries, on the effectiveness of the transmission mechanisms, and on fiscal consolidation efforts. However, nobody mentioned the idea of quantitative easing or fiscal easing for that matter. On the one hand, we all talk about European integration because we definitely want to be a part of the

European family with its standards and growth. On the other hand, we face very difficult reality because of the crisis. If we play our central bank role in an appropriate way, we will really make good progress in achieving our main goals which is not only price stability, but financial stability as well. This one is particularly sensitive in times of crisis.

Based on the Constitution of Albania, the objective of the central bank is price stability. Nevertheless, we spend a lot of our time on structural reforms in order to have growth. And here I do not mean only reforms in the financial sector that we are in charge of, but also reforms that are under responsibility of the government. If we can manage the current challenges, we will really fulfil our duty for the short term because in the long term we have our objective of being integrated into the European Community. So, basically everything has to be coordinated, combined. Within this framework, regional cooperation and sharing experiences among ourselves is of high importance. On the other hand, it is very important to have good communication with the European Commission – to be heard and to provide our opinions on the various policies that affect candidate countries.

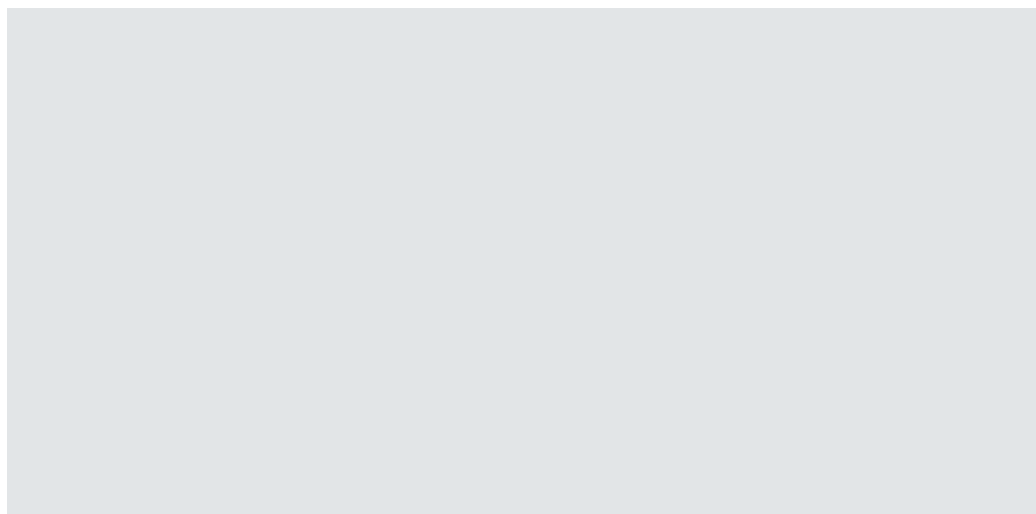
Let me say at the end, that we had a very fruitful discussion. Thank you.

Mejra Festić, Vice Governor, Bank of Slovenia; Central bank should continue to play the role of an independent and neutral institution in the country. It could provide additional liquidity to the economy through the banking sector, but it cannot repair the impaired transmission channels. The other economic policies must do that. There is a need for close cooperation between the central bank and the institutions responsible for other economic policies in the country. As a credible institution, the central bank should, besides taking care of confidence in the financial system and financial stability within its mandate, continue to assist other authorities in the country by developing proposals for necessary reforms and economic policies aimed at strengthening the process of transition and integration. Central banks are well positioned also as research institutions to perform the role because they have very rich databases and highly professional staff and the framework with strong methodological background for supporting other economic policies as well.

Jorgovanka Tabaković, Governor, National Bank of Serbia; We believe that the National Bank of Serbia, by fulfilling its mandate defined by the Law, already contributes significantly to the efforts of the Republic of Serbia on the road to European integration, and this is something we are doing for ourselves primarily and then for the purposes of membership in the European Union. Our primary statutory objective is to deliver low and stable inflation, i.e. price stability. Our secondary objective is to contribute to maintaining and strengthening financial stability, and in Serbia this means primarily maintaining and strengthening the stability of the banking sector. Our third, additional objective defined by the Law is to support the implementation of the economic policy of the Government of the Republic of Serbia, without prejudice to the main objectives, which is actually assistance in the implementation of structural reforms and fiscal consolidation.

Keeping inflation low may seem like a rather simple thing to do, but this is the result of the

work of the people sitting here. It also may seem simple to define the government's task – structural reforms and fiscal consolidation, but this truly is our main task and we do our best to assist in achieving this additional objective of ours because all monetary policy measures are worth little if we do not have results in structural reforms and fiscal consolidation. And to conclude, we need to do this for ourselves, not just for the European Union.



Final word of the moderator

Mojmir Mrak, Jean Monnet Chair Professor, Faculty of Economics, University of Ljubljana; It has, indeed, been a privilege to moderate this exceptionally rich panel. The panel has confirmed that the topic of the Conference was well chosen. It has become more than obvious that central banks play an increasingly important role in the overall economic governance of their respective countries. Experiences throughout the region have also confirmed strong contribution of central banks in their countries' dialogue with the EU on reformed European economic governance. They are all involved in preparation of ERPs as a new generation of documents supporting this process. In the case of Montenegro and Serbia, their respective central banks have also become the backbone for several chapters of the EU accession negotiations.

I would like to thank the panellists for their valuable contributions and the National Bank of Serbia for being an excellent host of the Conference. I wish you all a lot of success in your highly responsible jobs to the benefit of your respective countries including the process of their accession to the EU.



VI. Closing session

Thursday, 28 May 2015

Concluding remarks by the host

Jorgovanka Tabaković

Governor of the National Bank of Serbia

As a host, I would like to stress that the Conference has exceeded our expectations and I believe that we are one step closer towards identifying all the challenges that central banks face on the path of their countries towards the EU. I believe that yesterday's presentations and today's panel discussion have helped us understand not only how central banks can assist their countries to be accepted in this good company, but also how to deal with post-accession challenges and how to contribute to the development of that company. I would like to thank representatives of the central banks of Albania, Bosnia and Herzegovina, Montenegro, Macedonia, Slovenia and Turkey, or more specifically, I would like to thank Ms. Maja Kadijevka Vojnović, Ms. Ernadina Bajrović, my friend Mr. Turalay Kenç, Mr. Milojica Dakić, my neighbour Mr. Gent Sejko, my colleagues Ms. Mejra Festić, representatives of the institutions of the European Union, Mr. Gilles Noblet and Mr. Istvan Jakab, and above all, I would like to thank you, Mr. Mojmir Mrak, who provided valuable guidance to us not only in organising this event, but also in today's panel. I also thank my colleague Dušan Vujović, Minister of Finance, and Ms. Jadranka Joksimović, Minister for European Integration, who were here with us yesterday and contributed significantly to the quality of this Conference. I also thank Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) for the wholehearted support in organising this Conference. Still, I owe the greatest gratitude to my associates, some of whom are present here, who have worked hard so that all 35 negotiating chapters would be ready for opening. I always remind them that our main job is to perform the tasks that we are responsible for at the National Bank of Serbia, meaning that we fulfil our basic mandate, because by doing so, we will successfully carry out the tasks involved in the EU accession process. I am truly proud and deeply grateful to all of you, and I am most proud of all of my associates, as well as representatives of the Council. I am happy to be part of this team that raises such important questions and writes the history of Serbia on the path to the EU.

VII. Annex

Written contributions by Governors submitted on the sidelines of the Governor's panel

Mejra Festić

Vice governor of the Bank of Slovenia

STATEMENT

Non-standard monetary policy measures and their effectiveness in Slovenia

Non-standard monetary policy measures (NSMs) are called "non-standard" as they are meant to be temporary in nature and as they deviate from the way monetary policy was conducted prior to the crisis. The non-standard monetary policy measures were motivated by a need to ensure the continued effectiveness of the transmission of monetary policy stance in an environment where the financial system was subject to considerable stress. These measures were intended to *complement standard interest rate* decisions, rather than substitute them.

The financial crisis has impaired the channels through which the ECB official interest rate (MRO) was normally transmitted to the economy and consequently to prices. Together with providing liquidity and thus lowering market tensions, the aim of NSMs is therefore to enhance the effectiveness of the transmission mechanism by affecting market expectations with firming the accommodative monetary policy stance.

Why additional non-standard monetary policy measures may not be effective in Slovenia?

- **ABS (asset backed securities) and covered bond programmes face obstacles in Slovenia**
- **QE – the effect of bond purchases may be limited in Slovenia**
 - The QE does not ensure that banks will pass the additional liquidity into the private sector. These effects are not expected to be fully transmitted to loan pricing conditions, as banks remain risk-averse.
- **Given that banks are risk-averse and faced with very low-yield (or negative-yield) alternative assets, it does not guarantee that banks will be willing to sell bonds at all** (see next slide)
- **It is expected that the main effect will be through exchange rate and spillovers from higher demand in other EA countries** (favourable conditions for EA exports). Though some improvement in the functioning of interest rate channel is observed recently...
- **Slovenian government bond purchases will, according to Banka Slovenije capital key (0.4937%), amount to approx. EUR 200 mln per month (cumulatively approx. EUR 3.8 bn by Sept. 2016).**

There is limited willingness from Slovenian banks to sell SI bonds due to:

- large excess liquidity
- lack of available alternative investments in low-yield environment
- risk-averse investment policy
- aversion to negative yields
- SI market-makers envisaged moderate amounts of sales from their trading accounts.

There is obviously a need for other economic policies to help improving the transmission of monetary policy:

- Restructuring of enterprises
 - deleveraging (and equity increase)
 - improving governance practices
 - business restructuring
- Durable fiscal consolidation that would ensure sustainable improvement in government balances and improve the confidence of financial markets
- Other reforms that would boost longer-term potential of the economy

We can conclude that, the extent of the crisis has been extraordinary. **Non-standard monetary policy measures were introduced early in the crisis in order** to anchor long-term inflation expectations. **The range of NSMs is wide** and marked by a shift from the exogenous determination of Eurosystem balance sheet to its active use in pursuing medium term objective of monetary policy. However, the monetary policy is not able to repair the impaired transmission channels alone in the balance-sheet recession. Still, it could be effective in providing liquidity. The assistance of other economic policies is vital in this respect. **There are many impediments to more effective NSMs in Slovenia.** The main ones rest with risk-averse domestic banking system as well as with the undeveloped market for alternative instruments that would support the NSMs. In Slovenia, spill-overs will thus complement and could even dominate the direct effects of NSMs.

