AGENTS OF TRANSFORMATION:
THE ROLE OF THE WEST IN POST-COMMUNIST CENTRAL
BANK DEVELOPMENT

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Abstract

This paper addresses the puzzle of how relatively independent, Western-style central banks developed so quickly in post-communist democracies. I investigated this phenomenon through a broad analysis of central bank development in 19 post-communist democracies, and through intensive case studies of international training and technical assistance programs in Hungary, the Czech Republic, Russia, and Kyrgyzstan.

I draw two primary conclusions from this research. First, the training and technical assistance efforts of the Western central banking community have been the most significant cause of the convergence in ideologies, practices and organizational frameworks in the post-communist central banks. Second, this internationally generated convergence of central bank principles and practices has not led to a similar convergence in domestic economic results. The central banks have met with mixed success in carrying out monetary policies and in restructuring commercial banking systems and they have varying abilities to further develop themselves beyond this basic level. This research both illuminates the role of international actors in creating market-oriented institutions in post-communist democracies, and examines the conditions under which such externally influenced institutions may (or may not) forge legitimate, long-lasting domestic roots.
"The primary and ultimate objective of the International Monetary Fund's technical assistance in central banking has been . . . to enable [post-communist states] to formulate and implement the effective monetary and exchange policies that are necessary to stabilize their economies and move them to a path of sustainable growth. This objective necessitates . . . the establishment of central banks appropriately equipped to function in a market economy."

- IMF Monetary and Exchange Affairs Department, 1994 (emphasis added)

Introduction

This paper explores a profound puzzle: why did relatively independent, Western-style central banks develop so quickly in post-communist democracies? Existing theories view domestic actors as the primary architects of central banks, even those that argue that international financial pressures provide the underlying impetus for such institutional development. However, domestic actors in post-communist states uniformly lacked the expertise required to turn weak, command-oriented central banks into technically sophisticated, liberal ones. This initial institutional convergence in post-communist central banks appears even more curious given that other institutions (such as judiciaries, party systems, and corporate governance frameworks) have followed sharply different development trajectories across post-communist states.

I argue that Western-style central banks have emerged in post-communist democracies primarily because of the intensive efforts of a transnational (or "epistemic") community of central bankers in Western Europe and North America. In developing this argument, I address three complex and interlocking questions. First, have central bankers in post-communist states become integrated with the international community of central bankers? Do central bankers in post-communist states now have training, attitudes, and professional responsibilities similar to those of central bankers in Western Europe or North America? Second, are contacts with the international financial community responsible for the changes that have occurred? How influential have technical assistance and training programs,

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1 Haas (1992) defines an epistemic community as a transnational interest group with a unified "set of principles and causal beliefs" and a "shared policy enterprise." The phrase "epistemic communities" typically refers to groups of scientists or technocrats whose shared interests and expertise allow them to unite across national boundaries to affect broader political and/or institutional developments.
international meetings of central bankers, Western publications, and so forth been in the transformation process? Finally, have central banks in post-communist states developed domestic support for their altered missions, either from the government, from commercial banks, or from the public? This research both illuminates the role of international actors in creating market-oriented institutions in post-communist democracies, and examines the conditions under which such externally influenced institutions may (or may not) forge legitimate, long-lasting domestic roots.

I investigated this phenomenon through a broad analysis of central bank development in 19 post-communist democracies, and through intensive comparative case studies of international training and technical assistance programs in four post-communist states – Hungary, the Czech Republic, Russia, and Kyrgyzstan. Although all four began the transition period under distinctly different conditions, each of their central banks nevertheless evolved into relatively independent, Western-style institutions.

In the course of this research, I conducted 25 open-ended interviews with European central bankers and bankers in international financial institutions responsible for working with post-communist central banks. I then interviewed over 100 Hungarian, Czech, Russian, and Kyrgyz central bankers who took part in these training and technical assistance programs. I investigated to what extent these central bankers participated in the activities of the transnational central banking community, shared the educational, linguistic, and professional characteristics of this community, and internalized its core values. I also explored the practical effects of the assistance programs, assessing whether or not their intended goals were actually met, and whether or not unintended consequences resulted.

Finally, I distributed anonymous surveys to a representative sample of 250 central bank managers in Hungary, the Czech Republic, and Kyrgyzstan, with a response rate of 76%. These surveys collected basic demographic, linguistic, and educational information; and asked the bankers to identify and evaluate

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As a measure of democracy, I use the Freedom House Survey. According to this survey, 19 post-communist states earned at least a “4” (on a scale of 1 for “completely free” to 7 for “not free”) in both political rights and civil liberties for at least five years during the transition period, and could thus clearly be labeled either “free” or “partly free.” These countries include Albania, Armenia, Bulgaria, Croatia, the Czech Republic, Estonia, Georgia, Hungary, Kyrgyzstan, Latvia, Lithuania, Macedonia, Moldova, Poland, Romania, Russia, Slovakia, Slovenia, and Ukraine. While many of these states have problems with the quality
the foreign-led training programs in which they have been involved, to rate their bank in ten technical
development categories in comparison to “international standards,” to list the professional publications
they find most useful, and to give their opinions on twenty statements regarding central bank policy and
operations.

I draw two primary conclusions from this research. First, the active, extensive training and
technical assistance efforts of the Western central banking community have been the most significant
cause of the convergence in economic ideologies, basic techniques and practices, and internal
organizational frameworks in the central banks of post-communist democracies. This conclusion
supplements, not replaces, explanations focusing on the coercive pressures of financial globalization (i.e.,
IMF conditionality and the importance of demonstrating policy credibility to international financial
markets). While these arguments provide a motive for convergent central bank transformation, they
cannot explain how this development was carried out, or why it could happen so quickly. In contrast, my
explanation focuses squarely on the role of these Western “agents of transformation.”

Second, this internationally generated convergence of internal central bank principles and
practices has not led to a similar convergence in domestic economic results. Although fundamentally
transformed on the inside, post-communist central banks have met with decidedly mixed success in
carrying out effective monetary policies and in restructuring and regulating their commercial banking
systems. Perhaps more importantly, the central banks also have varying abilities to maintain and further
develop themselves beyond this basic level. Differences in these countries’ Soviet-era economic legacies
and in domestic political support for the changed missions of the central banks explain much of the
divergence. In short, this study reveals both the possibilities and the limitations of externally driven
institutional transformation.

In the rest of the paper, I first demonstrate that institutional convergence within the central banks
of post-communist democracies has occurred over the past decade and argue that current theories on

of their democratic institutions, for my analytical purposes they need only be democratic enough to make central bank
independence and transparency viable institutional outcomes.
The central banks in formerly command economies had inauspicious starting points from which to launch their massive transformation efforts. The structures and functions of central banks in command-oriented and market-oriented economies oppose each other in almost every substantive way (Table 1). Command-oriented central banks were designed for administrative and accounting purposes. They were subordinate to the government, fully integrated with the “commercial” banking system (hence their name, monobanks), and they disbursed state funds to enterprises and individuals. They had little or no control over monetary policy; indeed, the very phrase “monetary policy” was meaningless in the command economy. Staff in the monobanks typically did not have extensive backgrounds in economics, and positions within these banks had little prestige and paid poorly. Monobanks existed, in short, as a tool with which to fulfill government planning targets. As one long-time Hungarian central banker put it, after the collapse of communism “we had to learn everything in our chairs” (Rosta-Lutz 2000).
Table 1: Illustrative Differences in Command-Oriented and Market-Oriented Central Banking

<table>
<thead>
<tr>
<th></th>
<th>Socialist Monobank</th>
<th>Modern Central Bank</th>
</tr>
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<tbody>
<tr>
<td>Primary Goal</td>
<td>Distribute credit to enterprises, state</td>
<td>Price stability</td>
</tr>
<tr>
<td>Political status</td>
<td>Subordinate</td>
<td>Independent</td>
</tr>
<tr>
<td>Monetary policy tools</td>
<td>None, closed economy</td>
<td>Varied (e.g., open market operations, discount window)</td>
</tr>
<tr>
<td>Currency</td>
<td>Nonconvertible, dual monetary system</td>
<td>Convertible, unified monetary system</td>
</tr>
<tr>
<td>Payment system</td>
<td>Paper-based, slow</td>
<td>Electronic, RTGS (real-time gross settlement)</td>
</tr>
<tr>
<td>Accounting standards</td>
<td>Unique</td>
<td>IAS (international accounting standards)</td>
</tr>
<tr>
<td>Bank supervision</td>
<td>No separation between central and commercial banks</td>
<td>Numerous commercial banks, extensive regulation either by central bank or other agency</td>
</tr>
<tr>
<td>Employee education</td>
<td>Low, typically accounting</td>
<td>High, typically economic</td>
</tr>
<tr>
<td>Banker social status</td>
<td>Poorly paid, little prestige</td>
<td>Highly paid, prestigious</td>
</tr>
<tr>
<td>Economic environment</td>
<td>Non-market</td>
<td>Enterprises and banks responsive to central bank signals</td>
</tr>
</tbody>
</table>

Despite the similar structures and functions of their monobanks, though, there were also important differences among the 19 central banks of the post-communist democracies when they began the transformation process. These differences divide the states into roughly seven groups. The first includes only Hungary, which began in the most advantageous position. Before 1989 it already had its own currency and central bank, a comparatively open economy (including IMF membership), and a relatively recent history of capitalism. Not only did it have potential European Union membership to look forward to, but it began its transition earlier than other post-communist states. The second group includes Poland and the Czech Republic, which enjoyed all of Hungary’s advantages except its comparatively open economy at the start of the transition. The third group comprises Slovenia and Slovakia, legitimate EU hopefuls that began the transition a bit later and had to create their own currencies and central banks after the break-up of Yugoslavia and Czechoslovakia (the Czechs inherited the Czechoslovakian central bank in Prague).

The fourth group includes Bulgaria, Romania, and Albania, which had their own central banks and currencies but began the transition later and without realistic hopes of near-term EU membership. The fifth group includes Croatia, Macedonia, Latvia, Lithuania, and Estonia, which began the transition late, had to create their own central banks and currencies, and will not join the EU in the short-term. Russia itself is the sixth group. While it took over the Soviet central bank and controlled the printing of
rubles, it also began its significant economic transition later than the East European states and with the legacy of over 70 years of a command economy. Finally, the seventh group encompasses the post-Soviet states of Armenia, Georgia, Kyrgyzstan, Moldova, and Ukraine. These countries began the separation and transition late, with no advantages, and, at least in the Kyrgyz case, unwillingly. As the World Bank’s representative in Kyrgyzstan observed, the Kyrgyz central bank deserves more credit for its development efforts than the Hungarian, because given their starting points the Hungarian central bank experienced a less fundamental transformation (Mudahar 2001).

Both the stark opposition between command-oriented monobanks and market-oriented central banks, and the initial differences among post-communist democracies make the subsequent Western-oriented convergence in central bank structures and values surprising. These structures included legal frameworks, tools of monetary policy, payments systems, statistical bureaus, banking supervision and regulation frameworks, accounting systems, and frameworks for foreign exchange operations. The values underpinning these structures were those of the transnational central banking community – price stability and political autonomy. In short, this transformation involved changing both the preferences of post-communist central bankers and the technical capabilities of their central banks to conform to an accepted Western model.
Table 2: Post-Communist Central Bank Development

Evidence of convergence

What evidence do we have for this basic internal transformation and convergence? An analysis of six measures of central bank “Westernization” across the 19 post-communist democracies reveals the rapidity and similarity of this institutional development pattern. These measures include: 1) the central bank’s main goal, codified in law, is to defend “price stability” or “currency stability”; 2) the central bank enjoys formal legal independence from the government; 3) the central bank has maintained positive real interest rates for a full year; 4) the central bank has introduced current account convertibility for the currency; 5) the central bank can employ open market operations as a tool of monetary policy; and 6) the central bank abides by International Accounting Standards (IAS). As Table 2 demonstrates, 18 of 19

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3 I look at positive real interest rates rather than inflation rates because, while the central bank cannot control government spending and external borrowing, it can control the interest rate at which money enters the banking system. Positive real interest rates express the central bank’s intention to restrain excessive borrowing.

4 Although Bulgaria (1997) and Lithuania (1994) became currency board states, their central banks developed open market capabilities as well. The third currency board state in the region, Estonia (1992), did not.
central banks had fulfilled at least five conditions by 2001. In the most typical pattern, legal
independence and the price stability goal came first, followed by positive real interest rates, convertibility,
and open market operations, and finally by IAS adoption (interestingly, most states still not using IAS are
in East Europe). Overall, the message is clear. Post-communist central banks have actively adopted
Western banking standards and practices.5

Moreover, the ideological transformation that has taken place is evident from the survey data I
gathered in Hungary, the Czech Republic, and Kyrgyzstan. Table 3 shows these central bankers'
responses to nine statements about central banking. The first four are statements Western central bankers
would certainly agree with; the middle statement ("independent central banks contribute to economic
growth") is one that Western central bankers would agree with but which has never been demonstrated
empirically; and the last three statements are ones with which Western central bankers would typically
disagree.

5 Other studies confirm these general trends. Krzak and Schubert (1997) observe in their study of the Czech Republic, Hungary,
Slovakia, Slovenia, and Poland that "all important elements of modern monetary policy are in place." Radzyner and Riesinger
(1997) find the same for legal central bank independence, with the exception that direct central bank lending to governments is
gave a policy veto to government officials sitting on the bank's board. According to Maxfield (1997), the average level of
statutory central bank independence in 14 post-communist states from 1990-94 (using Cukierman, et al.'s coding) was .45,
comparable to Western Europe's .46 ranking. Finally, in the IMF's 1997 rankings of overall central bank development in post-
Soviet states, 7 of the 9 states I analyze received the top ranking of "3" (substantial progress), while the other two - Georgia and
Ukraine - received "2" (moderate progress) (Knight 1997).
Table 3: Central Bank Ideology

For each statement below, please choose an answer from the following:

5 Strongly Agree
4 Agree
3 Neutral
2 Disagree
1 Strongly Disagree

<table>
<thead>
<tr>
<th>Statement</th>
<th>Hu</th>
<th>CR</th>
<th>Kyr</th>
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<tbody>
<tr>
<td>Price stability should be the primary goal of the central bank</td>
<td>4.1</td>
<td>4.4</td>
<td>4.0</td>
</tr>
<tr>
<td>The central bank alone should determine monetary policy</td>
<td>4.5</td>
<td>4.3</td>
<td>4.5</td>
</tr>
<tr>
<td>Central banks should be independent from the executive</td>
<td>4.8</td>
<td>4.6</td>
<td>4.9</td>
</tr>
<tr>
<td>Independent central banks are especially important for democracies</td>
<td>4.2</td>
<td>4.5</td>
<td>4.5</td>
</tr>
<tr>
<td>Independent central banks contribute to economic growth</td>
<td>3.8</td>
<td>4.0</td>
<td>4.2</td>
</tr>
<tr>
<td>Central banks should be allowed to loan money to the government</td>
<td>2.3</td>
<td>2.0</td>
<td>2.4</td>
</tr>
<tr>
<td>Central banks should promote employment</td>
<td>2.4</td>
<td>2.5</td>
<td>2.9</td>
</tr>
<tr>
<td>Central banks should be allowed to allocate credit for specific purposes</td>
<td>2.6</td>
<td>2.5</td>
<td>2.9</td>
</tr>
</tbody>
</table>

In each case, the post-communist central bankers replicated the Western pattern of beliefs, even though they directly oppose the previous beliefs of central bankers in command economies. The belief pattern does not vary significantly by age or tenure at the bank, indicating that in many cases command-era central bankers have changed their beliefs (and/or that those not willing to change are no longer employed as central bankers). In addition, the central bankers share similar views on which central banks are most worthy of emulation. Of 114 central bankers who answered the open-ended question “Which central bank do you consider to be the best in the world?”, 37.6% said the U.S. Federal Reserve, 30.7% said the Bundesbank, and 19.3% said the Bank of England. My interviews revealed the same pattern – central bankers looked primarily to these three banks as models. As one Kyrgyz central banker said, “We know more about Western central banks than about central banks in the CIS [Commonwealth of Independent States]” (Aituganov 2001).
Table 4: Central Bank Self-Evaluation

In your opinion, how does your central bank rank in the following areas?

<table>
<thead>
<tr>
<th>Scale</th>
<th>Description</th>
<th>Hungary</th>
<th>Czech Republic</th>
<th>Kyrgyzstan</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>Completely meets or exceeds international standards</td>
<td>3.7</td>
<td>3.6</td>
<td>3.3</td>
</tr>
<tr>
<td>4</td>
<td>Comes very close to meeting international standards</td>
<td>3.4</td>
<td>3.3</td>
<td>2.6</td>
</tr>
<tr>
<td>3</td>
<td>Has made a lot of progress in moving towards international standards</td>
<td>3.8</td>
<td>4.2</td>
<td>2.9</td>
</tr>
<tr>
<td>2</td>
<td>Has made some progress in moving towards international standards</td>
<td>4.2</td>
<td>4.0</td>
<td>2.9</td>
</tr>
<tr>
<td>1</td>
<td>Has made no progress in moving towards international standards</td>
<td>4.3</td>
<td>3.6</td>
<td>2.9</td>
</tr>
</tbody>
</table>

Accounting systems and internal audit
Banking supervision and regulation
Foreign exchange operations
Monetary policy operations
Monetary analysis and research
Organization and management structure
Payment, clearing, and settlement systems
Public debt and securities market management
Central banking legislation

Finally, examining the highest possible hurdle, how close have these central banks actually come to meeting “ideal” international central banking standards? When asked to rank their central banks in nine areas of competence, the post-communist central bankers see significant progress across the board (Table 4). While the Kyrgyz rank themselves lower than do the Hungarians or Czechs, even they find that they have, on average, made “a lot” of progress in moving towards international standards in only eight years of transition.

The theoretical gap

Current theories on the origin and development of independent central banks cannot fully explain this internal institutional convergence. Most work on central bank development focuses entirely on
domestic actors and their incentive structures. The core of this literature, centered in economics, argues that independent central banks appear in democracies because elected politicians can only demonstrate a credible commitment to low inflation by tying their own hands in this way (Rogoff 1985; Cukierman 1992; Alesina and Summers 1993; Fratianni 1997; Miller 1998).

In this view, independent central banks restrain government officials from manipulating the economy for short-term political gains at the expense of the state’s longer-term interests. Other domestic political concerns may also encourage the creation of such banks. Boylan (1998), for example, frames the question in terms of distributive conflicts between left and right, arguing that in the Chilean case, the departing authoritarian government created a legally independent central bank to restrict the policy choices of the incoming democratic regime. Similarly, Maxfield finds that the character of the existing commercial banking system in a state “shapes the interests and capacities of early central banking institutions,” (1994, 563). However, while these state-level explanations may suffice in other regions of the world, the broad, simultaneous institutional convergence in East Europe and Eurasia clearly implicates international factors as significant causal agents.

Internationalist theories of central bank development fall into two categories: those focusing on incentives, and those focusing on economic ideologies. The “incentives” approach argues that states create autonomous central banks in order to signal their creditworthiness to the international financial community (Maxfield 1997). Another version of this approach looks at the way in which international economic forces affect the preferences of domestic “political entrepreneurs,” leading these domestic actors in turn to change the character of their state’s economic institutions (Frieden 1991; Frieden and Rogowski 1998). Conversely, the “ideology” approach emphasizes the role of a hegemonic state in exporting the economic ideologies underpinning such domestically generated institutions (Hirschman 1989; Loriaux 1997).

Ultimately, however, theories focusing on financial globalization’s domestic effects are also unsatisfying in this context. Although they correctly identify international factors as the primary
inspiration for institutional change in post-communist central banks, they still rely on domestic actors to build these institutions.

Creating Western-style central banks in post-communist states required more than political will on the part of domestic actors. It is a highly technical, complex process that poor, newly independent, formerly socialist states with command-era central banks could not carry out alone. In addressing this research question, therefore, I turn to the international relations literature on constructivism. The constructivist perspective analyzes the formation of state preferences and behavior, exploring how international norms and practices are transmitted from one group to another. This school departs from traditional international relations theory (which assumes the existence of objective national interests) to argue that international actors have the ability to "socialize" states into adopting new political and economic preferences and behaviors by influencing, teaching, and persuading domestic actors.

Drawing on these insights, I examine the socializing role of the transnational central banking community. Post-communist central banks did have significant political and economic incentives to become more integrated into the international financial system, but because of their long isolation, they did not know precisely what type or how much institutional change they wanted, nor how to reach that undefined point. Given this uncertainty, the epistemic community of central bankers had a unique opportunity to influence their institutional development paths in terms of both ideological and technical transformation.

**Central bankers as transformation agents**

By the late 1980s, central bankers (both from individual central banks in Western Europe and North America, and from the international financial institutions) had effectively coalesced into a

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6 The constructivist approach is based on the ideas in Berger and Luckman (1966), and it first emerged in international relations theory as part of the literature of international regimes. Some leading works in this vein included Haas (1990) and Ruggie (1983). The work of Peter Hall (1989) on the role of ideas in politics shares much in common with constructivism. For more recent constructivist approaches, which are more strongly informed by sociology (e.g., Mayer 1997), see Finnemore (1996), Katzenstein (1996), Evangelista (1999), and Wendt (1994; 1999). For a review and critique of constructivism, see Checkel (1998).
transnational epistemic community. After the collapse of communism, this community actively attempted to spread the institution of independent central banks to the newly transitional states (the text box on the next page lists the major members of this transnational community and briefly describes the kind and extent of their activities). It could do so because it possessed a core set of principles, motives, and means by which to mount this transformational campaign. One high-ranking Bank for International Settlements (BIS) official remarked to me in June 2000 that he didn’t know what the central banks of East Europe and the former Soviet Union would have done if the transition had occurred ten years earlier, because it was only at the beginning of the 1990s that Western central bankers had come to agree on a range of issues such as the Basel standards, banking supervision best practices, payments system standards, the use of exchange rate policies, and the focus on price stability. In fact, the first meeting of potential central bank aid donors provided the impetus to codify the by-then generally accepted wisdom, as the bankers discussed what they wanted to teach the central bankers of East Europe.

The key principles uniting the central banking community are price stability and political independence (Blinder 1998). As IMF deputy managing director Richard Erb bluntly said in his 1994 address to Eurasian central bankers: “Since the 1980s, there has been a convergence in thinking with respect to two ideas about central banking: first, that a central bank’s main mission should be to pursue and maintain price stability as the best strategy for sustainable economic growth; and second, that to achieve its main objective, a central bank should be independent from political influences” (Zulu, McCarthy et al. 1994, 131). The community’s assistance efforts have been directed towards instilling these principles in post-communist central bankers and equipping them technically with the tools needed to turn these principles into reality.
Major Central Bank Training and Technical Assistance Providers

**Individual Central Banks** – Approximately 25 central banks from the advanced industrialized countries (primarily, though not exclusively, European) have provided bilateral training and technical assistance directly to central banks in East Europe and Eurasia. This has taken a variety of forms, including accepting bankers for residential internships, conducting seminars both at the donor’s and at the recipient’s central bank, providing central bankers for short-term technical assistance programs, seconding central bankers for long-term assignments in recipient countries, coordinating aid with other central banks, and organizing specialized language training courses. The Bank for International Settlements (BIS) in Basel has served as a clearinghouse and coordinator for much of this activity. Two of the central banks most involved with this assistance have been:

- **Bank of England**: The Bank provides training and technical assistance through the Centre for Central Banking Studies. The Centre, founded in 1990 primarily to provide assistance to central banks in emerging post-communist states, conducts numerous on-site courses, academic workshops, and seminars abroad; distributes handbooks on central banking practices; and has responsibility for the organization and delivery of the Bank’s technical assistance. The CCBS has trained thousands of East European and Eurasian central bankers since its inception.

- **Deutsche Bundesbank**: The Bundesbank provides a full range of training and technical assistance to a wide variety of central banks, primarily in East Europe and Eurasia. From 1992-2000, it conducted about 200 training seminars abroad with around 6,000 participants, about 1,000 study visits and seminars in Germany with over 5,000 participants, and devoted over 7,000 person-days to consulting assignments.

**International Monetary Fund (IMF)** – The IMF, especially through its Monetary and Exchange Affairs division, has provided extensive technical assistance (typically in the form of short-term expert visits) to the central banks of East Europe and Eurasia. Most of the experts participating in these missions are current or former central bankers. The IMF also assigns resident advisors to post-communist states, and these advisors’ offices are located within the central banks. Finally, many East European and Eurasian central bankers have taken advanced courses at the IMF Institute in Washington, DC, which was established in 1964 to provide training in economic management.

**Joint Vienna Institute (JVI)** - The JVI was established in 1992 by the BIS, the IMF, the European Bank for Reconstruction and Development, the World Bank, and the Organization for Economic Cooperation and Development explicitly to provide economics training to officials from post-communist states. Since its inception, more than 14,000 officials from transition countries – many of them central bankers – have been trained at the JVI.

**European Union (EU)** – The EU provides technical assistance to East Europe and Eurasia in a wide range of areas, including central banking. The EU provides aid to East European candidates for enlargement through PHARE (founded in 1989), and to former Soviet states through TACIS (founded in 1992). In addition, the European Central Bank (ECB) provides high-level policy advising for central banks of EU candidate countries.

**US Agency for International Development (USAID)** – USAID conducts a variety of technical assistance programs for East European and Eurasian central banks, especially concerning issues of banking supervision. In addition, USAID is the primary funder for the Financial Services Volunteer Corps (FSVC), providing FSVC with close to $45 million in grants. The FSVC recruits former central bankers, commercial bankers, financial managers, and accountants to provide technical assistance to the East European and Eurasian financial sectors.

**World Bank** – The World Bank has funded a number of projects designed to improve the financial sectors in East European and Eurasian states. These projects often included components on central bank development, especially as it relates to banking supervision and payments systems.
The central banking community had two primary motives for undertaking this expensive, extensive aid effort. First, once the states of East Europe and Eurasia began to open their economies, they gained the power to affect the stability of the international financial system. Increasing financial interdependence means that the international financial system cannot remain stable over the long term without the cooperation of individual central banks in major states (Goodman 1989; Evans 1997). As the Bundesbank wrote in justifying its technical assistance programs: “Since the Mexican crisis of 1994-95, events have shown time and again that currency crises can be exacerbated considerably by unstable national financial systems. Measures to strengthen emerging economies’ financial systems are therefore of utmost importance (Deutsche Bundesbank 1999, 112).”

The second motivation, equally important but more difficult to quantify, has been to expand the influence and integration of the epistemic community of central bankers. Central bankers continually speak about their role in quasi-religious overtones, describing themselves as a “club” of similarly minded and educated individuals, working in a unique kind of institution, who are typically more capable than and misunderstood by their domestic governments and publics. As former Federal Reserve chairman Paul Volcker observed, central bankers “are almost uniquely able to deal with each other on a basis of close understanding and frankness” because of their common “experience, tenure, and training,” (cited in Helleiner 1994, 200). Therefore, once the changes started, it was a “normal desire” for these central bankers to want to provide assistance to their new compatriots (Szapáry 2000).

Finally, the central banking community had the means by which to disseminate these ideas and techniques to East European and Eurasian central banks. These means included money, staff, and organizational infrastructure. While central banks and international financial institutions do watch the bottom line, the depth of their funding was unique among potential aid donors. Furthermore, with the rise of the European Central Bank and the Euro, many Western European central banks found themselves woefully overstaffed for their diminishing roles. Training and technical assistance provided a fruitful new pursuit for many. Perhaps most importantly, the infrastructure for ideological and technological dissemination already existed. Central bankers continually reinforce and propagate their fundamental
principles through regular international meetings; the work of international financial institutions such as the IMF, the World Bank, and the BIS; collaborative central bank research programs and projects; and the financial media (such as Euromoney, Central Banking, and The Banker). Central bankers also speak a common language, literally—English is the universal language of central banking.

As a result, beginning in the early 1990s, the international central banking community began an expensive, concerted, hands-on effort to remold the central banks of East Europe and Eurasia on the Western model. They did this through a combination of technical assistance (designed to create a Western-style central banking infrastructure) and personnel training (designed to give post-communist central bankers the skills to use these new tools and to foster a “central banking culture” in these banks). As one Hungarian central banker observed a decade later, these efforts came to play a “tremendous role in changing the financial culture of the country” (Nagy 2000).

Preparations for delivering this assistance began at a series of high-profile meetings and conferences. For example, in August 1990 the Federal Reserve Bank of Kansas City sponsored a conference on “Central Banking Issues in Emerging Market-Oriented Economies” in Jackson Hole, Wyoming, with twenty-nine participants and eighty attendees. Western participants included Federal Reserve chairman Alan Greenspan and former chairman Paul Volcker, as well as top officials of the central banks of Canada, England, Switzerland, France, Belgium, and Germany; directors or division heads from Morgan Stanley, the Institute for International Economics, the National Bureau of Economic Research, Bear Stearns, and the IMF; and economics professors from five leading U.S. and European universities.

Participants from the East included the directors or deputy directors of the central banks of Poland, Bulgaria, Yugoslavia, the USSR, Romania, Hungary, and Czechoslovakia—in other words, every single “transition” state extant at the time except Albania. The initial meeting of donors at the BIS occurred the following year, after the G-7 central banks gave the BIS a mandate to coordinate the aid efforts for East Europe. This mandate was extended later, as 23 central banks from around the world agreed to cooperate with the BIS and the IMF to provide technical assistance to all 15 central banks in the
newly fragmented Soviet Union (Zulu, McCarthy et al. 1994). Regular BIS coordination meetings between donors and recipients soon became institutionalized. As BIS representative Corinna Balfour observed, the Eurasian central bankers had “stopped talking to each other” after the breakup, so the regular seminars and meetings played a vital role in bringing them together and integrating them into the central banking network (Balfour 2000). Through these meetings, the transnational central banking community continually reviewed and revised its technical assistance and training programs. A closer look at these programs reveals their significant scope and effectiveness.

**Technical assistance**

Technical assistance programs focused both on introducing Western-style central banking legislation, and on developing the organization and infrastructure of the central banks. In the legal arena, Western central bankers suggested legal changes, encouraged borrowing from Western models, and in many cases participated in the writing of the new laws. For example, the central bank laws of Hungary, Poland, and Czechoslovakia were modeled after the German law on the Bundesbank, while Slovenia copied both Austrian and German legislation.

IMF teams laid the groundwork for central banking legislation in Kyrgyzstan. Marat Sultanov, the former governor of the Kyrgyz National Bank, stated that “we discussed every letter and article” of the laws with IMF advisors (Sultanov 2001). In Russia, organizations like the Financial Services Volunteer Corps (FSVC) and the Russian-American Bankers’ Forum (co-chaired by former Federal Reserve Bank of New York director Gerald Corrigan), repeatedly gave detailed commentary on draft central banking laws. In a 1994 letter to Central Bank of Russia director Viktor Gerashchenko, the FSVC prefaces its 25-page commentary on the proposed revisions of the 1990 Russian central banking legislation by stating, in part:

This commentary is provided in recognition of the importance of establishing a solid legal foundation for the Central Bank of Russia to the development of the Russian financial system and the broader economy. Our comments . . . are intended to provide an objective analysis of its provisions based on broad experience regarding the functions and structure of central banks in market economies (Corrigan, Spindler et al. 1994).
The commentary stressed in particular the importance of firmly protecting the legal independence of the central bank and the desirability of phasing out even the limited proposition that in certain circumstances the CBR could provide credit to the Ministry of Finance for up to three months.

Western central bankers did their best to insure that central banking legislation in post-communist countries met Western standards as closely as possible. In some cases, Western central bankers even lobbied Eastern parliaments directly on behalf of the central banks. For example, at the beginning of the transition BIS director Alexandre Lamfalussy addressed the Hungarian parliament, explaining the need for modern central banking laws. György Surányi, the former director of the Hungarian National Bank, gives Lamfalussy personal credit for educating lawmakers about what central banks do and why legislation should stress price stability and legal independence (Surányi 2000).

Technical assistance programs to develop central bank organization and infrastructure have been many and varied. Technical assistance came in the form of short-term missions (usually IMF sponsored) and long-term advisors (“resident experts”) in individual central banks. In addition, the IMF Resident Representative had a private office in each East European and Eurasian central bank. While still occurring regularly in 2001, the most intensive technical assistance efforts took place in the early years of the transition. For example, from 1991-1996 Hungary received 14 short-term IMF technical assistance missions in areas related to central banking.

Two typical examples will illustrate the role that technical assistance has played in post-communist central bank development. First, Hungary (like other post-communist central banks) wanted to create a sophisticated statistics department in order to gather the accurate data necessary for economic forecasting. In 1994, the IMF sent a technical mission to the Hungarian National Bank that analyzed the bank’s current practices and recommended detailed changes. This sparked Hungarian visits to the statistics departments of the Austrian, Turkish, French, and Belgian central banks, and regular consultations with Western central bankers on methodology, new surveys, and new statistics. The statistics department continued to receive IMF advisors once or twice a year to discuss further changes. The department welcomed this contact. As one statistician observed, “We follow IMF international
guidelines not just because they recommend it, but because it's part of being a member of the international community (Durucskó 2000).” The Czech National Bank had a similar experience in developing its statistics department.

Second, technical assistance played the primary role in creating the internal auditing department of the Kyrgyz National Bank. Dick Reed, a consultant who had formerly worked 15 years in central bank internal audits, spent six months in Kyrgyzstan in 1994 laying the department’s foundations. The chief auditor referred to him as the “father” of the department (Aizhigitova 2001). This was followed by two key seminars for auditors at the Bank of France, and regular visits by a short-term advisor from Finland. As a result, not only did the department develop successfully, but the entire bank converted to International Accounting Standards in 1997. Kyrgyzstan had a similar experience with its foreign exchange department, which was initially crafted in great part by consultants from the Swiss National Bank (Aituganov 2001).

In short, although most East European and Eurasian central bankers have stories about individual technical assistance programs that were misguided, unhelpful, or otherwise problematic, they confirm in interviews that it would be hard to overestimate the overall importance of technical assistance in the rapid transformation of their banks. As early as November 1994, at a conference that brought together Western central bank donors and Eurasian recipients of technical assistance, statements by the Eurasian central bankers credited these programs with effecting significant changes. For example, Russian central banker Aleksandr Khandruyev (1994) noted that “[one] example of productive cooperation between the Central Bank of the Russian Federation and the IMF in the area of monetary control is the Central Bank of the Russian Federation’s gradual increase in the refinancing rate to market levels in mid-1993. This move was preceded by thorough preliminary work and a series of intensive consultations between the top leadership of the Central Bank and the Moscow office of the IMF.” These technical assistance programs allowed the central banks to gain technical capacity far earlier than they would have been able to manage on their own.
Training programs

Training programs sponsored by the transnational central banking community have included conducting seminars either at the donor's or at the recipient's central bank, founding training centers designed to teach specialized banking skills, and accepting East European and Eurasian central bankers for residential internships. For example, the Federal Reserve Bank of Kansas City has hosted numerous East European and Eurasian central bankers for six-month internships. Over 25 different central banks have regularly provided such specialized training courses and internship opportunities since 1990. In addition, the community actively assisted post-communist central banks in setting up their own domestic training centers. The training programs themselves were typically free for participants, although as the transition progressed the recipient central banks were more often asked to pay for transportation and accommodations. These programs aimed not only to pass on the knowledge necessary to run a Western-style central bank, but also to inculcate post-communist central bankers with the culture of the central banking community.

Two of the most important training initiatives were the creation of the Centre for Central Banking Studies (CCBS) and the Joint Vienna Institute (JVI). The Bank of England founded the CCBS in 1990 primarily to provide assistance to central banks in emerging post-communist states. In the training realm, the CCBS has conducted about 25 on-site courses per year, and many other specialized seminars abroad. As skill levels rose in the late 1990s, the CCBS also began holding intensive collaborative research workshops for more advanced students. To support these training efforts, the CCBS issued topical Handbooks in Central Banking to explain basic concepts to new central bankers in an accessible way. The first handbook, *Introduction to Monetary Policy*, appeared in 1996, and by 2001 the series included 21 titles. The CCBS was training over 1000 students each year by 2000, with over half still coming from East Europe and Eurasia (Centre for Central Banking Studies 2001).

The BIS, World Bank, IMF, OECD, and European Bank for Reconstruction and Development set up the JVI in September 1992 "in order to offer courses for officials of the central banks and of the economic and financial authorities of the countries whose economies were formerly subject to central
planning," (Joint Vienna Institute 2000). Each sponsoring organization has taught a number of its own specialized courses, usually lasting from a few days to two weeks. In addition, the JVI staff has taught a general 14-week seminar in Applied Economic Policy. In previous years this general course lasted five to six months, and was preceded by lengthy introductory courses held in several East European and Eurasian cities. Between 1992 and 2001, more than 14,000 officials from transition countries – many of them central bankers – were trained at the JVI.

The courses offered by individual central banks and by the JVI and CCBS changed over time, as post-communist central bankers gained more knowledge and experience. Far fewer courses were offered with Russian translation, the courses became more specialized, and the recipient central banks began to take a much more active role in requesting courses on specific subjects. These developments helped to solve many of the initial complaints post-communist central bankers had about their training experiences, as both donors and recipients came to know each others’ needs and expertise better.

Statistics gathered by both donor and recipient banks, as well as survey data, confirm that a majority of central bankers in post-communist states have taken part in at least one such training program (with many of the top specialists taking several courses over a number of years). The Central Bank of Russia, by far the largest of any post-communist central bank, sent employees to be trained by the hundreds in a wide variety of Western central banks. As the president of the Bundesbank noted with pride:

It is with Russia that the Deutsche Bundesbank is conducting the biggest and most intensive exchange of experts in the context of technical central bank cooperation. . . . Up to now, 49 seminars have been held in Russia, attended by over eleven hundred participants. In addition, 243 Russian specialists have visited the Bundesbank on study trips. In the past few years, the Central Bank of the Russian Federation has gained a good international reputation, especially in the light of its successes in combating inflation. I am delighted if our cooperation has contributed to that (Welteke 2001).

My survey of central bank managers indicated that 77% of respondents had taken at least one specialized course abroad and 73% had taken at least one course taught in-house by a foreign central banker. The Czechs were most likely to have taken a course, the Hungarians least likely, with the Kyrgyz in between. Participation rates were especially high in research and policy-oriented departments. One
Czech central banker estimated that 80% of the bank’s research division had spent at least six months abroad, typically in Britain or the United States (Matoušek 2000). In Kyrgyzstan, of 425 total central bank employees, 267 received specialized training in the year 2000 alone (Choraeva 2001). Table 5, which lists the number of participants sent to foreign training programs by the Hungarian and Czech National Banks in selected years, gives another indication of the wide scope of these training efforts.

Moreover, both donor and recipient central banks have found these programs to be extremely successful in fostering a culture of professionalism and shared expertise in East European and Eurasian central banks. In interview after interview, central bankers stated that training programs had been vital to their work and that they developed important, lasting contacts with other central bankers during these courses. One Bulgarian central banker described his training at the IMF Institute as a “revelation,” and explained that without this training the Bulgarian National Bank would not have been able to manage its own foreign exchange reserves (Galabov 2000). The JVI, originally designed to disappear in 1999, proved to be so useful that its founders extended its mandate and funding through 2004. An anonymous Russian correspondent for Central Banking observed as early as 1994 that:

There is a quiet revolution going on [in the CBR] . . . Russian professionals are discovering how institutions in what they quaintly call the civilized countries – i.e. mature market economies – work. This discovery is no accident. Western governments, institutions, and individuals have all leapt to help . . . It is difficult to know who was responsible for what, but in broad terms . . . there is some indication that the courses are being successful . . . the building blocks of a proper central bank are being put into place (Special correspondent 1994/5).
The survey results clearly reflected this perceived value (Table 6). Respondents were asked to rank the usefulness of foreign-taught courses taken at home and abroad, answering the question: "On a scale of 1 (not useful at all) to 5 (extremely useful), how useful were these courses to your work?"

Recipients in every country ranked the courses quite highly, with a top score of 4.6 for courses taken abroad by Kyrgyz central bankers. In short, the transnational central banking community offered a wide variety and number of training programs to East European and Eurasian central bankers, who in turn believe that their experiences in these courses played a key role in their evolution as central banking professionals.
Why were the majority of central bankers in East Europe and Eurasia so receptive to the transnational central banking community’s assistance in developing Western-style central banks, which might instead have been perceived as patronizing attempts to co-opt their institutions? Former Fed governor Paul Volcker himself puzzled over this in 1990, explaining why he thought East European states had become so enamored of Western central banking:

Inflation is part of the story, but it seems to me . . . the reason that there is so much talk about central banking is that it is very much tied up with ideas of sovereignty, of autonomy, of discretion, and of economic policy making . . . . [and] there is another, much more subtle reason for central banks . . . . Central banks around the world share certain common characteristics. They have a continuity of policy and staff and some degree of insulation – greater in some countries than in others – from the political process. It seems to me that they are typically centers of economic professionalism and training within governments and sometimes within countries. And partly because of those qualities, they are a natural focal point for international contact and interaction. (Federal Reserve Bank of Kansas City 1990, 5-6).

For post-communist central bankers, effective integration into the transnational central banking community promised a new kind of independence both for their states and their institutions. Post-communist states felt that establishing Western-style central banks would help them to establish monetary sovereignty within their own countries, and represented an important step in disaggregating the cross-regional command economic structures. This role became especially important in the USSR, where most of the 15 republics passed legislation declaring their central banks “sovereign” and “independent” in 1990 and 1991. Conditionality and credibility played a role as well, since international financial institutions and capital markets viewed independent central banks as important signals of a state’s commitment to economic reform.

Moreover, the fall of communism had wiped out the old paradigm under which these central bankers operated, and the introduction of market relations required them to carry out new tasks for which they were ill-trained and equipped. Western central bankers presented them with both a widely accepted set of principles and techniques under which they could operate, and an attractive, powerful community which they could join if they adapted to this model. The desire for sovereignty, financial necessity, and ideological conviction all came together in the institution of the Western-style central bank. Therefore, it
is no surprise that this relatively small group of East European and Eurasian central bankers, employed in very specialized organizations, embraced the integration process.

**Limitations of transformation**

It is important, however, to conclude with a word of caution. The convergence in basic central banking principles and practices that we have observed over the past decade will not necessarily lead to deeper institutional convergence or financial integration. Merely creating Western-style central banks in East Europe and Eurasia does not mean either that they will persist over time, or that their policies will have similar, desirable, or predictable effects in each country. Training and technical assistance programs can lay the intellectual and organizational groundwork for Western-style central banks, but they cannot ensure that these central banks will be able to develop further on their own, contribute to economic growth, or build domestic constituencies for their policies and continuing independence.

First, post-communist central banks increasingly differ in their capacities to absorb aid, especially advanced training. This is due to variations in turnover, language ability, and leadership. Central bankers in poorer states (typically former Soviet ones), where government positions pay less well, have a much greater incentive to seek other positions after they have been trained. One Austrian central banker noted that after JVI training, participants would often leave their countries, take jobs with international organizations, and/or go into the private sector (Dvorsky 2000). The Kyrgyz central bank, for example, has had a high turnover level. The governor of the Kyrgyz National Bank observed that Kyrgyzstan suffers from a psychology of “temporary people” – the best-educated and trained people do not want to stay in the country (Sarbanov 2001). As a result, the poorer the country, the more central bank training is wasted. This will likely become a larger problem over time, as the wealthier countries build up a stable core of central banking professionals while the poorer must continue to train new hires at more basic levels.

Turnover contributes to the language problem as well. Post-communist central banks go to great efforts to train their staffs in English. However, the central banks in poorer countries are more likely to
lose the English speakers that they train, and have a more difficult time finding new hires with English capabilities. The Kyrgyz central bank estimates that only about 30-35% of its staff can speak English freely (Choraeva 2001). Differences in language ability translate into differences in central bank development capabilities since international central banking conferences, seminars, and professional literature are all in English.

In addition, leadership plays a key role in affecting a central bank’s ability to take advantage of training and technical assistance. In order for a central bank to continue developing and attracting quality personnel, there must be stability and commitment at the top. The leadership, especially the governor, sets the tone for the rest of the bank. For example, when Surányi became head of the National Bank of Hungary in 1995, he immediately reorganized, modernized, and downsized the bank; raised salaries; and brought top young people into the research divisions. This in turn raised the prestige and capabilities of the bank.

Alternately, poor or politicized leadership can set the opposite tone. One Western central banker, describing the National Bank of Ukraine, said that “they’re interested in our advice at the expert level, but not at the board level. The board members are only interested in sightseeing.” Turnover, language ability, and leadership all affect post-communist central banks’ ability to further pursue the developmental path upon which they embarked with Western help.

Second, post-communist central banks have varying influence over their domestic economic environments. They experience four basic problems in this realm: poor transmission mechanisms for monetary policy, insufficient monetary sovereignty, incompatible fiscal policies, and economic uncertainty. Post-communist states typically do not have deep financial markets or sophisticated commercial banks, meaning that central bank attempts to affect the money supply through open market operations, reserve requirements, and such can prove ineffective or unpredictable. Many post-communist states have also experienced an explosion of barter and dollarization (Russia is the most notable example), further limiting the central bank’s room for maneuver. Uncooperative political leaders can engage in
fiscal policies that stymie the efforts of central bankers, even if the central bank itself does not lend to the government.

Moreover, all post-communist central banks face the broader problem of the uncertainty that goes along with a fundamental economic transformation process. As Czech central banker Vojtěch Benda admitted: “Traditional theoretical concepts just don’t work very well yet, although they’re starting to get more typical. Ten years just isn’t enough data on which to build models,” (Benda 2000). Therefore, while post-communist central banks have been given the official task of maintaining price stability and modern tools with which to do it, the external economic environment can thwart their efforts. The more difficult this external environment, the more often the central bank will fail in its task. The more the central bank fails in its task, the more prestige it loses and the more it can become a scapegoat for the economic problems plaguing the country. This, in turn, can lead to greater turnover, policy fluctuations, and calls to reduce the central bank’s independence. Given that economic conditions tend to become more difficult as one moves east and south in the post-communist world, this dynamic may contribute to divergence in central bank development and integration over time as well.

Finally, post-communist central banks, even in this set of 19 comparatively liberal states, face differing political conditions. All of these central banks have gone to great effort to build domestic political support and understanding through publications, websites, research, museums, television shows, newspaper columns, and the like. Some, however, have been more successful than others. As a rule, the central banks in countries that plan to join the European Union have received greater political support than central banks in other countries, because a competent and independent central bank is a requirement for EU membership. Also as a rule, the most significant political challenges to central bank independence have occurred under two circumstances: currency crises and banking crises. In countries as diverse as the Czech Republic, Russia, Kyrgyzstan, and Bulgaria, central bank policies were blamed for massive, rapid currency devaluations. Likewise, central bankers are often criticized both for wanting to close problem banks (before banking crises), and for not closing problem banks (after banking crises). In general,
political interference is of special concern in those post-communist countries where once-promising
democratic development has stalled or gone into reverse.

The differences in post-communist central banks' abilities to absorb aid, economic environments,
and political support mean that the initial convergence that has occurred among these central banks,
sparked by Western aid efforts, will likely not persist over time. Central banks may find themselves
captured in either "virtuous" or "vicious" circles for further development.

Those banks operating under more hospitable conditions will be able to deepen their
professionalism and integration into the transnational central banking community. On the other hand, those
emerging central banks laboring under less hospitable conditions will run a much greater risk of
institutional stagnation and erosion of independence. This may lead to alienation, where central bankers
come to identify much more closely with central bankers abroad than with their own governments and
publics. It may also promote the "decoupling" of these central banks' newly adopted formal principles
and roles from their actual capabilities and practices, a trend which would engender outwardly Western-
style institutions that become increasingly isolated and impotent domestically.

The transnational central banking community's efforts to transform the central banks of East
Europe and Eurasia achieved remarkable results in the 1990s. Externally driven institutional
development, though, can only go so far – internal conditions must support the changes in order to
generate a "virtuous circle" of evolution.

Ironically, the central banks with the most likelihood of success – those in Central-Eastern Europe – are the ones most likely to
disappear as the EU enlarges. As Hungarian central bank governor Surányi (2000) observed: "We're lucky now because we have
some flexibility – but the more credible our policy, the more we converge with the EU, the less room we have for maneuver.
We'll have to adjust . . . the trend seems irreversible."
References


## Appendix: Relevant Websites

### East European and Eurasian Central Banks

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