

IX. ECONOMIC POLICY COOPERATION IN ESTONIA AND ABROAD

CONCLUSION OF ACCESSION NEGOTIATIONS

Estonia similar to Cyprus, Czech Republic, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia completed accession negotiations with the European Union in December 2002. Eesti Pank participated in negotiations on four Chapters: free movement of services, free movement of capital, Economic and Monetary Union and institutions. Negotiations on the latter started in 2002. Eesti Pank was also involved in the working group on statistics.

ACCESSION NEGOTIATIONS BY CHAPTERS

Free Movement of Services

The Chapter legally regulates the freedom to provide services, including financial services. An essential principle is to ensure providers of financial services freedom to offer cross-border services, ie the activity licence is valid throughout the EU internal market. The home country of the undertaking has a right to issue licences and an obligation to organise supervision of service providers. The EU acquis in financial services should ensure credibility of the financial markets and providers of financial services, common rules on the EU internal market and appropriate consumer protection.

The Chapter on free movement of services was provisionally closed on 12 June 2001. Estonia has applied for transition periods under deposit guarantee directive and investor compensation scheme foreseen under the directive. The transition periods have been granted. As the guarantee system is financed by market participants, taking into consideration the level of income in Estonia and the volume of deposits and investments compared with EU Member States, a higher compensation level would cost relatively more for the Estonian financial sector and would inhibit Estonian market participants' competitiveness. The minimum compensation will grow gradually, depending on Estonia's economic situation, a rise in the level of income, a need for an accumulation period and proportionality between the volume of deposit and investment services and amounts of compensation. The minimum amount of 20,000 euro required by the EU directives is intended to reach by end-2007 at the latest.

Estonian legislation regulating free movement of services and more specifically financial services is mostly in compliance with the requirements outlined in EU directives. The remaining slight changes in the legislation (Credit Institutions Act, Insurance Activities Act, Securities Market Act, Financial Supervision Authority Act, Law of Obligations Act, etc) will be introduced by the accession date at the latest.

Free Movement of Capital

Free movement of capital is one of the underlying principles of the common market and the Economic and Monetary Union. Legal provisions on the movement of capital are limited to Articles 56–60 of the Treaty on European Union. As the result of the negotiations, Estonia can permanently keep the restrictions against the third countries, which were in force on 31 December 1999. Estonia was also granted a seven-year transition period as of the accession. During this period Estonia may maintain the rules regarding the acquisition of arable land and wooded land to EU citizens and legal persons.

*In negotiations on the Chapter of free movement of capital, Eesti Pank participated primarily in issues regarding the payment system and prevention of money laundering. In these fields Estonia has not applied for transition periods or derogations. Since the entry into force of the Law of Obligations Act and the Securities Market Act, in July 2002 and early 2002, respectively, Estonian legislation is in compliance with the *acquis* in payment and settlement systems. The interbank payment and settlement system introduced at the beginning of 2002 is fully in compliance with international standards and best practice. The Money Laundering Prevention Act complies with the EU anti-money laundering directive¹ in force; amendments pursuant to the second EU anti-money laundering directive² will be introduced in 2003.*

Economic and Monetary Union

The European Economic and Monetary Union (EMU) is an integral part of the European Union. All EU Member States participate in one or another way in EMU. EMU allows achieving the EU primary economic policy objectives – first and foremost, sustainable economic growth and low inflation level. EMU derives from two pillars – coordination of Member States' economic policies and single monetary policy. New Member States, including Estonia, will not fully participate in EMU, ie they will not belong to the euro area countries.

*Estonia's negotiations on the Chapter of EMU were provisionally closed on 7 December 1999. Similar to other accession countries Estonia will have the status of Member State with a derogation after joining the EMU, ie a derogation on joining the third phase of EMU and adoption of the single currency. In order to become a full member in EMU, states have to draft and implement an economic and fiscal policy programme, ie a convergence programme. The second criterion for full membership is legal: Member State economic, fiscal and monetary policy legislation should be harmonised with the EU *acquis*. The third criterion to enter the*

¹ Directive 91/308/EEC on prevention of the use of the financial system for the purpose of money laundering.

² Directive 2001/97/EC of the European Parliament and of the Council of 4 December 2001.

Eurosystem lies in the compliance with the Maastricht criteria, which should ensure nominal convergence of the entrant's economy and euro area economies.

With the adoption of the Central Bank Act Amendment Act by the Riigikogu on 22 January 2003, Estonian legislation complies with the EMU acquis to the extent that allows the state to meet its obligations as a Member State with a derogation.

Institutions

The Chapter on institutions mainly covers the composition and functioning of institutions and bodies established under the Treaties and secondary legislation, working languages and administrative matters. The Chapter covers also provisions for adjustments of the institutions agreed upon at the Intergovernmental Conference and Nice European Council. The acquis under this Chapter needs no harmonisation and implementation prior to accession.

The negotiations started in 2002 and were provisionally closed on 11 July 2002. The Chapter covered also ECB-related provisions. The Governor of Eesti Pank will become a member of the ECB General Council upon Estonia's accession to the European Union and a member of the ECB Governing Council upon full membership in EMU. Enlargement-imposed amendments to the ECB Statute were also handled under this Chapter.

ECONOMIC POLICY DIALOGUE AND COOPERATION WITH EU STRUCTURES

New forms of economic policy dialogues were first introduced in 2001 and the cooperation deepened in 2002. The most significant EU economic policy cooperation forum is the Economic and Financial Committee (EFC). EFC alternate members' committee prepares the meetings. Representatives of accession countries, including Eesti Pank, participated in two EFC meetings in 2002 – on 26 March and 30 October. A meeting on the level of alternate members on 17–18 October preceded the latter. Economic policy coordination last autumn focused on Pre-accession Economic Programmes (PEP) of the accession countries. Ecofin approved conclusions drawn on the level of the EFC on 5 November.

High-level visits deepened the cooperation. Eesti Pank hosted EFC President Johnny Åkerholm on 6 March and a delegation of the Committee on Economic and Monetary Affairs of the European Parliament on 29 November. The meetings focused on the performance of Estonian monetary policy system and development of the financial sector and the economy.

Convention on the Future of the European Union

Accession countries are represented similar to Member States in the Convention, except that they cannot block Member States' consensual decisions. This is the representation principle also on the level of working groups. Eesti Pank participated in preparing Estonian position on EU economic policy and the representative of the central bank at the Estonian mission to the European Union was an alternate member of the economic policy working group in the Convention.

Dialogue about the Europe Agreement

Dialogue about the Europe Agreement is a form of cooperation between the EU and accession countries. In 2002, representatives of Eesti Pank participated at the meeting of the Association Committee; information on more specific developments was exchanged in the internal market sub-committee and economic and monetary policy sub-committee. In the internal market sub-committee representatives of Estonia and the EU informed each other of the developments in the *acquis* and in the markets; the economic and monetary policy sub-committee focused on the analysis of the current situation and outlooks in Estonian and EU economies, also on such long-term and structural issues as fiscal strategy and pension reform.

European Central Bank

As of the signing of the Treaty of Accession, which took place in April 2003, Estonia is invited to attend as an observer in the work of the ECB General Council and ESCB committees. Throughout 2002 cooperation continued in the current forms. In several fields, including IT infrastructure, close practical cooperation has been achieved.

On 5–6 December, representatives of Eesti Pank, ESCB and ECB met at the fourth annual meeting in Genval, Belgium. The seminar focused on exchange rate issues, financial stability and the development of the infrastructure. Countries are expected to intensify preparations for participation in the exchange rate mechanism (ERM2). It was also stressed that the optimal length of the transition period and full participation in EMU would depend on the preparedness of each country.

In October, regular seminars with accession countries were held on monetary transmission mechanism, exchange rate systems and accession countries' operational convergence with the Eurosystem. Meetings on banking and balance of payments statistics take place 3–4 times a year.

In 2002, a large number of mutual visits took place. On 25–26 April, representatives of ECB Division of EU Neighbouring Regions visited Estonia. They discussed a relatively broad range of topics – progress at real convergence, stability of inflation, structure and development of capital markets. Also several missions from the ECB visited Eesti Pank. They assessed progress in statistics, settlement system, accounting, information technology, internal control and document administration. Opinions were exchanged with the ECB experts on monetary policy operational framework in pre- and post-accession periods.

Internship in the ECB for experts from accession countries' central banks is a new form of cooperation added.

COOPERATION OF THE EUROPEAN INTEGRATION IN ESTONIA

The coordination of the European integration in Estonia is within the competency of the Prime Minister, whereas line ministries and agencies are responsible for performing EU integration-related tasks in their area of governing. In 1996, in order to enhance cooperation and exchange of information coordinating bodies were established, including the **Office of European Integration** and **Council of Senior Civil Servants** (CSCS). The CSCS consists of representatives of Eesti Pank and ministries who attempt to reach consensus in multiagency issues. The Council is also a forum of information exchange. *Vis-à-vis* the upcoming accession, the Government of the Republic approved a plan to reform organisation of the European integration 'Need and the System for Internal Coordination in Estonia as an EU Member State' on 10 December 2002. The new system will be launched in spring 2003. In order to ensure timely exchange of information, strategic

planning and problem solving, the CSCS will be reorganised into EU Coordination Council, with the same composition. The main function of the Council would be to ensure a harmonised national position, solving of disputes, exchange of information and mapping and solving of various EU related issues.

COOPERATION WITH INTERNATIONAL MONETARY FUND

Estonia's cooperation with the International Monetary Fund is primarily related to rights and obligations arising from the IMF membership. The Governor of Eesti Pank as a member of the Board of Governors and Secretary General of the Ministry of Finance as an alternate member attend the IMF annual meeting. In 2002, the annual meeting was held on 28–29 September in Washington. The advisory body to the Board of Governors – the International Monetary and Financial Committee (IMFC), comprised of 24 representatives elected by Member States, meets twice a year. These bodies evaluate the performance of the IMF and issue guidelines for future. During both the annual meeting and IMFC meeting (in April and September) the representatives of Eesti Pank participate in the meetings of the Nordic-Baltic Constituency and at multiple bilateral meetings with other central banks and international institutions.

Daily cooperation with the IMF is conducted through the Nordic-Baltic Constituency, which represents Estonia. The constituency includes eight countries (Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden) that elect a representative to the Executive Board of the IMF. To participate in the daily work and decision-making process, the constituency has to harmonise the position of eight countries on issues handled in the Executive Board. Every two years a country is elected to coordinate the position of the constituency. In 2002–2003 the Bank of Iceland is the representative. Besides daily harmonisation of positions on issues discussed in the Executive Board, more significant issues are discussed four times a year in the monetary and financial committee of the constituency and in the alternates' committee. In the committee, each member state of the constituency is usually represented by secretary general of the line ministry responsible for IMF issues and deputy governor of the central bank.

In 2002, **the economic policy cooperation between Estonia and the International Monetary Fund** was related to regular economic policy consultations under Article IV of the IMF Articles of Agreement (on 18–30 April) and shorter assessment missions (on 13–19 February and on 5–9 August). Primarily fiscal and monetary policy issues vis-à-vis EU accession and potential implications of soaring domestic borrowing and current account deficit on the sustainability of Estonian economy were discussed. IMF reports on Estonia as well as the updated assessment of the application of international standards and codes in Estonia are published on the IMF home page³. In 2000–2001, Estonia was assessed in fiscal and financial sector transparency, financial sector supervision and statistics – all in all in seven fields. In 2002, for the tenth anniversary of the reintroduction of the Estonian kroon the IMF and Estonian experts compiled an analytical review of the monetary reform and implications of the currency-board-based monetary policy on the economic development 'The Estonian Currency Board: Its Introduction and Role in the Early Success of Estonia's Transition to a Market Economy'⁴.

In 2002, Estonia participated in the IMF and World Bank initiative for the Heavily Indebted Poor Countries (HIPC)⁵. The creditor countries finance the programme at least in proportion to their relative quota in the IMF. In March 2002, the Government of the Republic and Eesti Pank supported the HIPC initiative with 372,000 SDR (approximately 8.3 million kroons), using partly the funds already in the above

³ <http://www.imf.org>

⁴ By Adalbert Knöbl, Andres Sutt and Basil Zavoico, IMF Working Papers WP/02/96. Eesti Pank has translated the paper also into Estonian.

⁵ See International Monetary Fund, p 52.

IMF's special account (149,000 SDR or approximately 3.3 million kroons). The Government of the Republic decided to allocate an additional contribution of 5 million kroons on 19 March.

COOPERATION WITH OTHER INTERNATIONAL ORGANISATIONS

Eesti Pank is a shareholder in the Bank for International Settlements (BIS) and has 200 BIS shares with voting rights. The Governor of Eesti Pank participated in the annual meeting of BIS on 8 July 2002 and at the regular meetings of the governors of central banks, held six times a year. Representatives of the central bank participate also in the annual meeting of coordinators of BIS technical assistance.

With other international organisations, like the World Bank, the European Bank for Reconstruction and Development (EBRD), Organisation for Economic Cooperation and Development (OECD), NATO, etc, Eesti Pank relates on the level of national working groups. At the meetings with representatives of the above institutions, the function of the central bank is to assess the development of Estonian economic and financial sectors and introduce its monetary policy principles. Eesti Pank participates in drafting an annual report under OECD Baltic Regional Programme. Over the last two years, after the publication of EBRD annual Transition Report, Eesti Pank invites representatives of the EBRD to the bank to introduce its evaluation of the development of Estonia and other transition countries.

EESTI PANK AND SOVEREIGN RATING

Estonia's relations with international rating agencies and daily exchange of information are coordinated by Eesti Pank. The central bank has rating agreements with all three major rating agencies (Standard & Poor's, Moody's Investors Service and FitchRatings). Once a year analysts from the rating agencies visit state agencies, commercial banks and undertakings as well as meet with economic and political experts in Estonia⁶. After the visit, the rating agencies complete for their customers a more detailed country report on Estonia's economic and economic policy outlooks; the compliance with the rating is monitored throughout the year.

JOINT SEMINARS WITH OTHER CENTRAL BANKS

The annual joint seminar of the Baltic central banks was held in Lithuania on 9–10 May 2002. The seminar focused on central bank accounting system, information technology, payment systems and related legal issues. Joint seminars for three central banks were held also in the field of cash management, statistics and internal audit. Broader issues in the cooperation of the central banks are dealt with at the biannual meeting of deputy governors of the Baltic central banks.

Eesti Pank and the Bank of Finland held already the tenth joint seminar that took place in Estonia. The main topics included EU integration through the eyes of the two central banks, experience of the Bank of Finland in the adoption of euro notes and coins, reforms by the Basel Committee in calculating capital adequacy and central banks' experience both in providing administrative services and reserve requirement risk management services. Traditionally also economic and fiscal policy development of both countries was under discussion.

⁶ See Sovereign Ratings: Estonia and Other EU Accession Countries, pp 24–25.

BILATERAL MEETINGS AND VISITS

In 2002, bilateral cooperation with central banks in other countries and other financial institutions continued. Working visits, exchange of information and discussions took place at very different levels. Many experts from different departments of Eesti Pank as well as all members of the Management were involved. Main cooperation partners for the departments of the central bank have been Nordic central banks whose experience in the daily work and performance of the coordination mechanism of the EU national central banks is extremely valuable for us. Bilateral meetings and visits in 2002 handled general issues of central banks' daily performance in the ESCB and other EU institutions' coordination system as well as financial stability, management accounting and human resources management.

On 25–28 February, members of the Board of Eesti Pank visited Ireland. During the visit they met with top executives and experts in the Bank of Ireland and Ministry of Finance. They discussed preparations to join the euro area, including adjustment through single market and economic and legal convergence. One of the points of interest was Irish economy and its recent leaping growth. As regards daily operation of the central bank, the ESCB decision-making process, the role of the central bank in financial stability and financial sector supervision as well as payment systems and supervision were under focus.

Eesti Pank has been open to share experience to several Eastern European countries. On the initiative of the monetary policy analysis and advisory centre at the National Bank of the Ukraine, preparations were launched in 2002 to prepare an inter-central-bank cooperation project. The Ukraine was interested to learn Estonian experience under currency board arrangement, to draw up a comparative analysis of Ukrainian and Estonian experience and to get recommendations as regards the European integration. As the first stage, Eesti Pank organised a seminar for the Ukrainian delegation in November to give a comprehensive overview of the core activities of the central bank and Estonian monetary policy and economy.

EESTI PANK'S INTERNATIONAL RELATIONS DEVELOPMENT DURING THE LAST TEN YEARS

International relations of the central bank after the reintroduction of the kroon reflect the development of Estonian financial system and economy.

Immediately after the restoration of independence, Estonia joined the most important international financial organisations. Pursuant to Decision of the then Supreme Council of the Republic of Estonia No 258 of 22 April 1992 Estonia became a member of the International Monetary Fund (IMF), the World Bank and the European Bank for Reconstruction and Development (EBRD). Ever since Eesti Pank has been responsible for Estonia's participation in the IMF and has been its main partner in daily economic policy cooperation.

The role of the IMF in supporting our economic development throughout our restored independence has been remarkable. Six economic policy Stand-by Agreements have been signed between Estonia and the IMF in 1992–2001. The agreements provided a facility to borrow in case of economic difficulties up to 100 million SDR, ie about 2 billion kroons. The single facility was up to 30 million SDR, ie about 600 million kroons. Due to rapid economic recovery Estonia had to borrow just once, in 1992. For Estonia, the Memoranda of Economic Policies of the Republic of Estonia as an integral part of the General Agreements to Borrow

were extremely significant. The economic policy memoranda allowed both the government and the central bank to consult the IMF in core political issues and considerably increased confidence in Estonian economy and economic policy. While in early 1990s the economic policy memoranda were confidential, since 1999 both Estonia and the IMF have published the entire document on their web sites. The last memorandum of this kind was in force in 2000–2001. Strong and efficient relations with the IMF analysts have continued after the memoranda expired.

Similar to Estonia, relations with the European Union became increasingly important also for Eesti Pank. The central bank has participated in solving European integration issues since early nineties, participating in the work of a working group that analysed Estonia's potential accession to the European Union. Ever since Eesti Pank has been involved in solving EU related issues internally, primarily through the Council of Senior Civil Servants but also in substantial negotiations with the EU. In 1995–1997, Eesti Pank participated in drawing up an association agreement between Estonia and the European Union (Europe Agreement) and since late nineties has been involved in accession negotiations' working groups. Since 1997 experts from the bank have participated also in drafting Estonia's Medium-Term Economic Programme (MTEP). Multilateral cooperation between the European Central Bank and accession countries goes back to 1999, starting in the form of joint seminars.

Over the last ten years, the Bank of Finland and other Nordic central banks have provided Eesti Pank invaluable assistance, supporting our development towards an EU national central bank. Since 1992 regular seminars between the central banks of Finland and Estonia on top executive level have taken place. Current cooperation between departments and experts has become a routine. In 1992, annual seminars of the Baltic central banks were launched on the initiative of Eesti Pank. Besides bilateral contacts in the relations between Eesti Pank and Baltic and Nordic countries, harmonisation of positions of the IMF constituency is significant. Since 1999 this has been done in the Nordic-Baltic Monetary and Financial Committee. Beginning from the second half of the nineties, Estonia has actively participated also in the coordination system of the Nordic-Baltic Constituency. First top-level meetings to harmonise economic policy positions were in 1998. Initially the work was done at the Nordic-Baltic Constituency Committee but on 1 January 2000 the Nordic-Baltic Monetary and Financial Committee was set up.