# I. ESTONIA AS A PART OF THE ENLARGING AND CHANGING EUROPEAN UNION

On 1 May 2004 the biggest enlargement in the history of the European Union took place: ten new Member States including Estonia joined at a time[1]. Since 1 May 2004 there are 25 Member States in the European Union. The enlargement increased the EU population to 450 million people, i.e. by 20%. The gross domestic product of the EU increased by 4.5%. Simultaneously, the European Economic Area (EEA) expanded, comprising besides EU-25 also Iceland, Liechtenstein and Norway.

## INSTITUTIONAL IMPLICATIONS OF ENLARGEMENT AND CONSTITUTIONAL TREATY

The enlarging and evolving EU has created a need for changes also in EU institutions. In 2000, the Nice European Council agreed upon institutional changes necessary for efficient performance of the Union. The Treaty of Nice entered into force on 1 February 2003[2]. From the beginning, the Treaty of Nice has been a temporary solution and in 2001 a European Convention was established to draft a new Constitutional Treaty for the European Union. Next the Intergovernmental Conference (IGC)[3], which has a right to amend EU treaties, resumed work with the treaty. Under successful leadership of the Irish Presidency Member States reached an agreement on the treaty in June 2004. EU heads of state and government signed the Constitutional Treaty in Rome on 29 October. All the Member States have to ratify the Treaty; some have promised to run a referendum for ratification. If all Member States ratify the Treaty, it will enter into force on 1 November 2006. By 15 March 2005 four Member States (Lithuania, Hungary, Slovenia and Spain) had ratified it. The European Parliament has approved the Treaty as well. The Government of the Republic of Estonia decided that the Riigikogu would ratify the Constitutional Treaty. The process will start in spring 2005.

[1] Apart from Estonia also Cyprus, the Czech Republic, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia.
[2] The Treaty of Nice introduced the following substantial changes: the Council of Ministers has now 321 votes in total, Estonia has 4 votes. As of 1 November 2004 the European Commission will consist of one Commissioner from each Member State, previously five larger states had two each. In early June new Member States could elect members to the European Parliament; in 2004–2009 Estonia shall have 6 seats of 732.
[3] Accession countries could participate both in the work of the Convention and IGC on an equal footing with “old” Member States.

## ENFORCEMENT OF EU CONSTITUTIONAL TREATY: MAIN CHANGES IN INSTITUTIONS AND ECONOMIC POLICY

*The Treaty establishing a Constitution for Europe (Constitutional Treaty) was drafted with an objective to simplify the system of current Treaties and ensure the performance of an enlarged union. It was also necessary to clarify competences of Member States and each of the EU institutions as well as to amend the voting system. The introduction of the concept of the European Union was a major simplification.*

***Institutional issues**. From 2014 on the Commission will consist of a number of Members corresponding to 2/3 the number of Member States (until 2014 one Commissioner per Member State). The Council of Ministers presidency will remain unchanged; however, three Member States will share presidency for 18 successive months. Qualified majority will become the general rule for the adoption of decisions within the Council of Ministers. Unanimity remains the rule for a few fields only (including taxation). The number of seats in the European Parliament will be raised from 732 to 750; the minimum number of seats per country will be six (currently four). The Constitutional Treaty will establish two new posts – the EU Minister for Foreign Affairs and the President of the European Council. The EU will have a simplified hierarchy of legislation. Legislative acts will be laws and framework laws (currently regulations and directives), which are to be adopted by co-decision of the European Parliament and the Council of Ministers. Non-legislative acts will be regulations, decisions, recommendations and opinions.*

***Economic policy**. The role of the European Commission in monitoring economic policy will be strengthened. Differences between economic policy monitoring of the euro area and non-euro area countries will increase. The euro area countries have the possibility of deciding themselves on questions of particular concern to them. Members of the euro area will have a unified representation and common positions in the international arena. Pursuant to the Annex – Protocol on the Euro Group – the Euro Group member states shall elect a chairman. The euro area accession procedure was amended, the role of the euro area was enhanced: before the Council, in its full formation, can make such a decision, it must receive a recommendation from the euro area member states. Members of the Executive Board of the European Central Bank shall be appointed by a qualified majority.*

## EUROPEAN UNION ECONOMIC POLICY

The EU economic policy coordination focuses on the objective set in the Lisbon Council in 2000 to become the most competitive knowledge-based economy in the world. However, the EU economic growth has remained below the potential level in recent years. Economic issues were high on the agenda for Irish and Dutch Presidencies in 2004. In 2004, public finances discipline was in the limelight, which was problematic for twelve Member States (including six new entrants).

The central coordinating mechanism of the EU economic policy is **Broad Economic Policy Guidelines** (BEPG). These guidelines, covering both the EU and each Member State individually, relate to activities necessary for achieving agreed objectives. The Broad Economic Policy Guidelines are for a three-year period and the current guidelines were adopted in 2003 for the period of 2003–2005. Meanwhile the guidelines are updated. The 2004 update outlined three priorities:

- Sustainable economic growth;
- Flexible labour market;
- Sustainable public finances.

Competitiveness and productivity are closely related to the situation in Member States' labour markets, the flexibility of which is considered too low to achieve strong economic growth. Progress is evident in labour market and pension reforms and in opening of several significant markets (e.g. telecommunications, electricity) to competition although these sectors are still in need of further reforms. Efforts to finance research and development and promote social sustainability are necessary. Progress has been made in the implementation of the Financial Services Action Plan.

The Stability and Growth Pact is one of the underlying pillars of the European Economic and Monetary Union (EMU). However, the academic community has long been discussing its implementability and economic foundations. Frequent breaches and creative interpretation of the rules of the Stability and Growth Pact encouraged discussions on amending the pact. The topic has been under discussion in the Council of Ministers, its committees and working groups. The European Commission also drafted its vision of how to make the pact more flexible and strengthen performance. As the pact is a main underlying pillar of the single monetary policy, the European Central Bank and Member States' central banks have been more critical vis-à-vis amendments of its rules. In March 2005, the EU Finance Ministers agreed on amendments of the Stability and Growth Pact and the European Council approved of the amendments. The objective was to make the pact more flexible. Current quantitative limits on the budget deficit and public debt (3% and 60% of GDP, respectively) are still in force and "at good times" tight fiscal policy should be implemented. However, various factors can be taken into consideration in assessing budget deficit (e.g. implementation of the pension reform, policies and investments to fulfil the Lisbon strategy).

In the second half of 2004, a topic closely related to competition appeared on the agenda, namely the **reduction of administrative burden**[4]. In early 2004, four successive Presidencies (Ireland, the Netherlands, Luxembourg and the United Kingdom) tabled a position that a better regulatory environment would contribute to the accomplishment of Lisbon goals and additional burden to economy arising from regulations should be curbed. Simplification of legislation aims to improve EU business environment and competitiveness. In November, the Council of Ministers decided that simplification of the legislation would start in environment, statistics, internal market, company law, social policy, public health, agriculture, and transport.

In 2004, discussions about the next **financial framework for 2007–2013** started. The multi annual spending framework lays down categories of expenditure in compliance with EU political objectives (headings), ceilings for each heading for each year and maximum amounts of the EU's own recourses.

## INVOLVEMENT OF NEW MEMBER STATES IN EU ECONOMIC POLICY COORDINATION PROCESS

The year 2004 was a transition year in EU economic policy coordination, i.e. new Member States were integrated into various coordination processes. They became involved in the assessment cycle of stability and convergence programmes and are also subject to excessive budget deficit procedure. **Economic and fiscal policy coordination** is one of the main underlying pillars of EMU. All states draw regularly up their economic programme (euro area countries present a stability programme, others submit a convergence programme), which is coordinated among themselves and with the European Commission. The programmes are oriented to maintenance of balanced budget as provided in the Stability and Growth Pact and in case of non-euro area countries also to meeting the Maastricht criteria.

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[4] 'Administrative burden' is defined as "costs arising from an obligation to report and inform stemming in its turn from business legislation and regulations".

The new Member States submitted their **first convergence programmes** in May 2004, for 2004–2008. Annual programme updates are submitted at the end of the year, as a rule, and a joint assessment is made early next year. Main concerns for the new Member States involve high budget deficit, the pressure of aging population on long-term budget sustainability and, in the Baltic States, also current account deficit.

In May 2004, the European Commission issued recommendations for Member States with excessive budget deficit. Within the framework of Broad Economic Policy Guidelines (BEPGs) and the annual report on structural reforms the new Member States, including Estonia, were issued **recommendations to improve economic environment**. In 2005, for the first time the new Member States will be evaluated in a BEPGs implementation report.

Twice a year (in spring and in autumn), the European Commission publishes revised **economic forecasts**. In spring forecasts of 2004, for the first time the new Member States were covered as thoroughly as other Member States.

The new Member States were involved also in the ECB **monetary policy coordination exercise**. The report published twice a year presents monetary policy objectives and strategies of non-euro area EU Member States against the setting of ECB monetary policy. The report provides an overview of latest economic developments and growth outlooks both in the euro area and non-euro area Member States.

### PROGRAMMES AND REPORTS SUBMITTED BY ESTONIA WITHIN EU ECONOMIC POLICY COORDINATION PROCESS

- Fiscal Notification, i.e. government budget and debt report (spring, autumn)
- Convergence programme (usually at the end of the year, the first programme for 2004–2008 was submitted in May 2004; annual updates and forecast revisions are submitted in the interim years)
- Report on Economic Reforms, i.e. the Cardiff Report (autumn)
- Employment Action Plan (autumn)

## EU FINANCIAL SECTOR POLICY

The integration of financial markets is a significant way to promote EU economic growth. Thus, the **Financial Services Action Plan (FSAP)** was elaborated in 1999; it expired in 2004 but substantial work on the topic continues. There was also a need to discuss how to move forward with financial market integration. In principle, Member States reached an agreement that the adoption of new EU legislation should be suspended and a refocus on the implementation of adopted legislation is necessary.

In early 2004, the European Parliament adopted new **directives on securities markets and investment services**. The Council of Ministers achieved a political agreement on the Capital Adequacy Directive for banks and investment companies and the Directive on Money Laundering and Terrorist Financing and forwarded them to the European Parliament.

In the near future work with a new legal framework for payment systems will continue. If the new framework and two directives submitted to the European Parliament are adopted, the adoption of all FSAP directives will be completed.

In addition, the Council of Ministers reached a political agreement on a directive establishing a new structure of financial services committees. The directive extends the Lamfalussy committee[5] structure from securities market also to banking and insurance sectors. Four new committees will be set up: banking and insurance sector committees as well as banking and insurance supervision committees.[6]

In 2004, agreements between the EC and Switzerland, Liechtenstein, San Marino, Monaco, Andorra, the UK and the Netherlands' associated territories (15 altogether) were signed and concluded on taxation of savings income in the form of interest payments. Thus, on 1 July 2005 the EU Directive on Taxation of Savings Income, commonly known as the Savings Directive, will enter into force.

[5] Alexandre Lamfalussy headed the so-called Committee of Wise Men, which proposed a reform for enabling the speedy adoption of legislative proposals in the securities sector.
[6] The directive was processed by the previous membership of the European Parliament but the new President did not sign the draft directive in early-2005 and thus the establishment of a new structure of financial services committee has been postponed.