

## VIII. ECONOMIC POLICY CO-OPERATION IN ESTONIA AND ABROAD

Co-operation with domestic partners and international institutions as well as with central banks of other countries is becoming increasingly important from year to year as regards the key performance of Eesti Pank. Pursuant to the goal of the Republic of Estonia to accede to the European Union (EU) and the need to continuously strengthen and upgrade Estonia's financial system, Eesti Pank maintains the closest working relations with the EU institutions and the International Monetary Fund (IMF).

### EESTI PANK'S ROLE IN EUROPEAN INTEGRATION

In recent years the various forms of co-operation between Eesti Pank and the EU have continuously developed and advanced, reflecting Estonia's deepening economic as well as general economic and political integration to the European Union. The central bank participates in preparing Estonia's integration documents and in negotiating the accession. There is also a regular dialogue in the framework of the Association Agreement (Europe Agreement). Economic policy co-operation has tightened and its forms have become more varied. Among others, the co-operation of Eesti Pank was tightened in 2001 with the European Central Bank and the European System of Central Banks.

#### GENERAL POLITICAL DOCUMENTS IN EUROPEAN INTEGRATION

Eesti Pank together with other state agencies is drafting the National Programme for the Adoption of the *Acquis*<sup>1</sup>. Eesti Pank has a significant role in preparing the chapters on free movement of services, free movement of capital, the European Economic and Monetary Union (EMU) and statistics. The aim of the National Programme drafted in the end of 2001 was to complete the necessary steps for the accession already in 2002, leaving the year 2003 for the enhancement of administrative capacity. In 2002–2003, Eesti Pank's main steps in preparing the accession to the European Union are related to the modification and implementation of banking sector regulations (primarily the new capital adequacy guideline), elaboration of the implementation documentation regulating the new settlement system and its operation, updating the Central Bank of Estonia Act and continuing the monetary policy operational framework reform.

Estonia also makes an annual contribution to another general policy document on accession to the EU – the integration report submitted to the European Commission (Progress Report). The document focuses on the fulfilment of the tasks undertaken in previous National Programmes and other development tendencies in integration areas. Eesti Pank participates in preparing the part of the National Programme dedicated to economic development and, of course, in explaining the issues related to the above negotiation chapters. Based on the candidate countries' Progress Reports, the European Commission drafts a summary report about the readiness of these countries for the accession to the EU.

<sup>1</sup> National Programme for the Adoption of the *Acquis* is submitted to the European Commission. Full text of the document is published by the Office of European Integration of the State Chancellery on its web page at <http://www.eib.ee/pages.php/01030103>.

## ACCESSION NEGOTIATIONS ON CHAPTERS RELATED TO EESTI PANK

By April 2002 Estonia had provisionally closed 24 chapters of the European Union legislation. Eesti Pank participates in the EU negotiations in three chapters: free movement of services, free movement of capital and the EMU. The central bank is also involved in the statistics workgroup. All of the above chapters have been provisionally closed by now.

One of the sub-topics of the chapter on **free movement of services** is related to banking. After adoption of the **Credit Institutions Act Amendment Act** on 13 December 2001, the legislation of the Republic of Estonia is fully in compliance with the current EU *acquis* in this area. Regarding the Directive 94/19/EEC on deposit-guarantee schemes, a conversion period was agreed until the year 2007. The chapter was provisionally closed on 30 March 2001.

Regarding **free movement of capital**, Eesti Pank is primarily involved in sub-topics concerning the payment system and money laundering prevention. After the adoption of the **Contractual and Non-Contractual Obligations Act** and the **Securities Market Act** at the end of 2001, the legislation of the Republic of Estonia is in total compliance with the *acquis* in the area of payment and settlement systems. A new payment system was launched in the beginning of 2002. Along with the introduction of the new system, a committee of experts is formed to serve as an arbiter in settling possible disputes. The legislation of the Republic of Estonia is in full compliance with the requirements of the EU Directive 91/308/EEC on Money Laundering Prevention<sup>2</sup>. The chapter on free movement of capital was provisionally closed on 26 May 2000.

Estonian economic and monetary policy principles and legislation largely correspond to those of the **European Economic and Monetary Union (EMU)**. By the time of accessing the EU, Estonia will be ready to adopt the above chapter in the extent of the *acquis* that enables the country to participate in the EMU as a non-single currency country<sup>3</sup>. One of the priorities in 2002 is to make amendments in the Central Bank of Estonia Act.

## DIALOGUE ABOUT THE EUROPE AGREEMENT

The dialogue arising from the Association Agreement between Estonia and the EU has a significant place in the framework of the accession to the European Union. The dialogue is held annually on the level of the Association Council, the Association Committee and its sub-committees. Representatives of Eesti Pank participate in the meetings of the Association Committee, the Internal Market Sub-Committee and the Monetary and Financial Issues Sub-Committee, where the parties inform each other about the current issues in the areas of economy, finance and the financial services market.

The meeting of the Association Committee on 14 June 2001 was held in Tallinn. During the meeting, the Estonian part made a survey of the overall economic situation and gave brief information about the development of the financial system. At the meeting of the Internal Market Sub-Committee on 31 May, there were also discussions on setting up the financial supervision and developing the legislation concerning payment and settlement systems. At the meeting of the Monetary and Financial Issues Sub-Committee on 9 November, information was exchanged about the situation of the Estonian and European Union economies and financial systems.

Experts of Eesti Pank participated also in the development of Estonian economic policy position (viewpoints) before the meeting between Estonia and the EU Association Council in February.

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<sup>2</sup> See Arrangements for Combating Money Laundering and Terrorism in Estonia, pp 59.

<sup>3</sup> Country with derogation.

## FORMS OF ECONOMIC POLICY DIALOGUE

Since 2001 the forms of economic policy co-operation between the EU and the candidate countries have become ever more similar to those of the EU Member States. The representatives of Eesti Pank along with government agencies participated in the meetings of the bodies co-ordinating the EU economic policy – at the extended meeting of the Economic and Financial Affairs Council (Ecofin) on 21–22 April in Malmö and at the meetings of the Economic and Financial Committee (EFC) on 27 June in Stockholm and on 27 November in Brussels.

At Ecofin meetings Eesti Pank is represented by Vahur Kraft, Governor of Eesti Pank, at the EFC meetings by Deputy Governor Märten Ross. Eesti Pank prepares a part of the Pre-accession Economic Program concerning the monetary and financial sector policy and co-operates in the field of improving Estonia's economic forecast methods.

Traditionally Eesti Pank continued to participate in the regular working meetings of the Eurostat balance of payments workgroup and the monetary, financial and balance of payments statistics committee. Participation in the financial account workgroup was new.

## ADMINISTRATIVE CAPACITY ASSESSMENT MISSIONS IN 2001

For the purpose of assessing the administrative capacity of the Estonian financial sector supervision<sup>4</sup> Estonia was visited by a mission of experts from six EU Member States in April 2001 that assessed supervision in three sectors – banking, insurance and securities market. The assessment was based on the results of the financial sector assessment carried out by the International Monetary Fund (IMF) and the World Bank in 2000 in a respective programme<sup>5</sup>, because the conformity of the financial sector supervision to international standards had been assessed just a year earlier. The earlier assessment enabled to make a more thorough analysis of the situation and focus on the implementation of the recommendations formulated by the IMF and the Word Bank.

As there was also a need to assess money laundering prevention in candidate countries, which became especially topical in connection with the 11 September terrorist attack in the US, the European Commission organised an additional mission in December 2001 in the framework of the same programme aiming to assess the sufficiency of current money laundering prevention legislation and institutional framework in Estonia<sup>6</sup>.

The European Commission has also pointed out Estonia's *progress in improving its administrative capacity in all sectors, including a successful implementation of the acquis, which is more complex, costly and time-consuming than simple amendment of legislative provisions.*

## CO-OPERATION WITH EUROPEAN CENTRAL BANK

The economic policy dialogue between Eesti Pank and the ECB has tightened since the year 2000. Specialists of main departments of Eesti Pank have visited their colleagues at the ECB to gain experience. The co-operation has been tighter in the areas of statistics, payment systems and banking legislation<sup>7</sup>.

<sup>4</sup> Peer Review Program.

<sup>5</sup> Financial Sector Assessment Program, FSAP.

<sup>6</sup> For conclusions of the mission, see Arrangements for Combating Money Laundering and Terrorism in Estonia, p 59.

<sup>7</sup> See Developments in Statistics, pp 52–53; Main Development Trends in Ensuring Financial Stability in 2001, pp 56–59.

Eesti Pank participated in the **meeting of representatives of the European System of Central Banks, the ECB and central banks of candidate countries** in Berlin on 6–7 December 2001 and in the preparatory workshop in Frankfurt on 24–25 October. Eesti Pank prepared a thorough overview of the Estonian financial sector for the purpose, which has also been published separately<sup>8</sup>.

The ECB analyses the banking law of candidate countries on a regular basis, working meetings of lawyers take place 3–4 times annually. The ECB lawyers visited Eesti Pank on 7–8 May. The aim of the visit was to update the report on assessment of candidate countries' legislation prepared in 2000, assess the new redaction of the Central Bank of Estonia Act and developments in the legislation regulating Estonian financial markets, as well as to familiarise with the structure and operating principles of the Financial Supervision Authority. The issues of the legislative framework for the monetary policy were also analysed at the bilateral meeting held in Frankfurt on 31 October.

Issues concerning the changeover to euro cash were discussed on several occasions in 2001 with participation of the candidate countries. In co-operation with the ECB, Eesti Pank prepared and issued an information folder and a booklet<sup>9</sup>. In the period of introducing euro cash, Eesti Pank forwarded information to the ECB about the demand for euro cash in Estonia and other issues related to the introduction of the euro. With the participation of the ECB, a seminar Introduction of Euro Cash and Prevention of Counterfeits was organised in Tallinn on 16 November for the representatives of Eesti Pank and commercial banks.

The first stage of a joint project between the EU candidate countries and the ECB was completed in April 2001, in the framework of which **the first part of the methodological manual about Money and Banking Statistics in the Accession Countries** was prepared. It was published in print and also on the ECB web page. The book contains information about the arrangement of money and banking statistics in the candidate countries. The second stage of the work will be carried out in 2002. The second part of the manual describing the practices of collecting and preparing statistics about interest rates, securities and other financial issues in the candidate countries will be added.

Methodological manual **Accession Countries: Balance of Payments and International Investment Position Statistical Methods** is under preparation. It will be published in February 2002 and also made available electronically on the ECB web page. Estonia is participating in this project, as well.

There were also three seminars on payment and settlement systems (on 14–15 February, 19–20 March and 3–5 September) and an accounting and financial reporting seminar for the candidate countries (on 4–5 October).

## ECONOMIC POLICY CO-OPERATION BETWEEN ESTONIA AND INTERNATIONAL MONETARY FUND

According to the inter-institutional division of labour, Eesti Pank communicates primarily with the International Monetary Fund and the Ministry of Finance primarily with the World Bank. For the purpose of forming a necessary common position to make economic policy decisions, Eesti Pank and other state and government agencies co-ordinate their opinions. In 2001, the co-operation with the International Monetary Fund was primarily related to regular economic policy consultations under Article IV of the IMF Articles of Agreement, completion of economic programmes related to the Stand-by Arrangement as well as co-operation activities in the Nordic-Baltic Constituency<sup>10</sup>.

<sup>8</sup> The Structure and Functioning of the Financial Sector in Estonia. Eesti Pank, Tallinn 2002.

<sup>9</sup> See Participation in Presenting Euro Banknotes and Coins, p 86.

<sup>10</sup> The constituency includes Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden.

## COMPLETION OF THE ECONOMIC PROGRAMME RELATED TO STAND-BY ARRANGEMENT

The term of the Stand-by Arrangement signed with the IMF expired in August 2001 and the inherent economic programme (also known as the IMF Memorandum) for eighteen months came to an end. The latest or the sixth economic programme focused on sustainable fiscal policy and further reforming of the public sector. The government and Eesti Pank fulfilled all the main promises. The central bank was involved mostly in the creation of a consolidated financial supervision and further development of the monetary policy operational framework based on the European integration. A new similar economic programme will not be made any longer in the framework of the IMF's loan arrangements. The economic policy co-operation with the IMF continues in the form of annual consultations.

## ESTONIA'S PARTICIPATION IN THE INITIATIVE FOR THE HEAVILY INDEBTED POOR COUNTRIES

The IMF member countries agreed in 1999 that the Initiative for the Heavily Indebted Poor Countries (HIPC) would be financed from the sale of IMF's gold and additional subsidies by the IMF member countries. The aim was to collect 2.1 billion US dollars in the special fund. The crediting countries decided to finance the programme at least in proportion to their relative quota.

Estonia has participated in the IMF's initiative for poor countries earlier, as well. In 1997 Estonia allocated its resources in the IMF's special account as an interest-free loan to the ESAF<sup>11</sup> credit line. In March 2002, the Government of the Republic and Eesti Pank supported the HIPC initiative with 372,000 SDR<sup>12</sup> (approximately 8.3 million kroons), using partly the funds already in the above 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.

## NEW COMPLIANCE ASSESSMENTS

In addition to the IMF's assessments of monetary and financial sector policy transparency and observance of financial sector supervision standards carried out in 2000, the IMF assessed the transparency of Estonia's fiscal policy as well as availability and quality of statistics in 2001<sup>13</sup>. Both of the assessments are very positive. Estonia is one of the first countries that have successfully passed the majority of the assessments carried out by the IMF to assess the compliance with international standards and good practices.

## CO-OPERATION IN THE AREA OF STATISTICS

Following a proposal by the IMF, Estonia participates in the Coordinated Portfolio Investment Survey covering 70 countries, the aim of which is to collect detailed information about portfolio investments as at 31 December 2001. In future the study will be carried out annually. The year 2001 marked a preparatory stage of the study (planning, compiling questionnaires etc). The actual data will be gathered in 2002 and forwarded to the IMF.

The central bank also participated in a joint project of the IMF and the Organization for Economic Cooperation and Development (OECD), the aim of which was to get an overview about the standards and methods used for collecting statistics on direct investments in different countries.

<sup>11</sup> ESAF (Enhanced Structural Adjustment Facility) with a new name of PRGF (Poverty Reduction and Growth Facility) – subsidised long-term credit line to the poorer IMF member countries.

<sup>12</sup> Special Drawing Rights, a unit of account of the IMF.

<sup>13</sup> See Developments in Statistics, pp 52–53.

## CO-OPERATION IN NORDIC-BALTIC CONSTITUENCY

The central banks and ministries of finance of the constituency countries co-ordinate their activities to formulate a common viewpoint in economic policy issues. The aim is to ensure that the Director representing the constituency in the Executive Board of the IMF would have an overview of economic policy positions of the countries of the constituency. In 2000 and 2001 the positions in the Nordic-Baltic Constituency were co-ordinated under the leadership of the Bank of Finland. In Estonia, other government institutions are also involved in the development of the country's position if necessary.

Apart from the daily harmonisation of the views on issues under discussion in the Executive Board of the IMF, major issues are discussed earlier three or four times a year in the constituency's monetary and financial committee and the deputies' committee. The committee includes representatives of the government and the central bank from each country of the constituency, as a rule, the Secretary General of the ministry involved with the IMF (the Ministry of Finance in Estonia) and the Deputy Governor of the central bank.

## CO-OPERATION WITH RATING AGENCIES

Relations with rating agencies are essential for all countries in the world as the cost of money borrowed by a country and its major companies from the world markets is determined by the country rating. Estonia's relations with rating agencies and daily exchange of information is co-ordinated by Eesti Pank. The central bank has rating agreements with all three major rating agencies (Standard & Poor's, Moody's Investors Service and Fitch).

**The year 2001 marked a great step forward for Estonia on the country trustworthiness scale.** Fitch and Standard & Poor's raised Estonia's rating to the level of A- (it had been BBB+ since the year 2000). Moody's left Estonia's rating on the level Baa1. A highly significant role in the assignment of ratings is played by the stability of the Estonian economic policy, conservative fiscal policy, continued economic growth and the future accession to the European Union.

While earlier country rating used to determine the ceiling of the ratings assigned to all companies in the country, the loss of restrictions on the movement of capital and integration of international financial markets have made the agencies change their rating methodology. Strong international corporations and companies with a solid investor base can now also get a higher rating than the country of their location. In Estonia, for instance, such a rating was assigned to Hansapank.

## CO-OPERATION WITH OTHER INTERNATIONAL ORGANISATIONS

The Bank for International Settlements (BIS) organised a seminar **Monetary Policy in the Eastern European Countries** for the first time in June 2001. The seminar focused on monetary policy objectives and ways of achieving these in the rapidly developing Central and Eastern European countries, possibilities for becoming a member of the EMU and relations between the monetary policy and the financial system.

The extraordinary general meeting of the BIS decided on 8 January 2001 that from now on only the central banks could be shareholders in the BIS<sup>14</sup>. In addition to that, the BIS made a proposal to the

<sup>14</sup> Until the beginning of the year 2000, shares in the BIS fell into three: shares with voting rights held by central banks (85%), shares without voting rights held by central banks (1%) and shares without voting rights held by private investors (14%). Central banks and private investors could buy BIS shares when a central bank did not use its right to purchase the shares designated to it. According to the Articles of Association of the BIS, the share capital is divided into 600,000 shares of which 529,165 shares were issued at the end of 2000. The nominal value of a BIS share is 250 gold francs, ie pre-war Swiss francs.

central banks to re-sell all shares without voting rights. The repurchase price of shares without voting rights was 16,000 Swiss francs per share. This equals the price for which the BIS repurchases all the shares held by private investors.

Eesti Pank had 200 BIS shares with voting rights and 500 shares without voting rights that Estonia had bought in a private placement organised for the Belgian central bank in 1932. The General Manager of the BIS made a proposal to Eesti Pank on 20 September 2000 to sell the above 500 shares without voting rights to the BIS. The Governor of Eesti Pank agreed to re-sell the shares on 11 October that year. The transaction was made in 2001, bringing 82 million Estonian kroons of extraordinary income to Eesti Pank.

In 2001 the Governor of Eesti Pank participated in the annual meeting of the BIS and in the monthly meetings of the governors of central banks.

Joint activities with the Organization for Economic Cooperation and Development (OECD) continued through a workgroup consisting of representatives of Estonian government agencies and in the framework of the Baltic regional programme. In 2001 Eesti Pank did not participate directly in the projects, but made a contribution to the drafting of the annual meeting report in the area of the regional programme.

## JOINT SEMINARS WITH OTHER NATIONAL CENTRAL BANKS

Joint seminars with other Baltic central banks and the Bank of Finland continued. In 2001, the eighth **Seminar of the Baltic Central Banks** was held in Riga. The seminar focused on three central banking issues: monetary policy, public relations of the central bank and the foreign reserve management.

The ninth **Seminar of Eesti Pank and the Bank of Finland** was held in Oulu, Finland. One of the most significant topics discussed at the seminar has always been the current economic and financial sector situation in Estonia and Finland. At this seminar the Finns also gave an overview of a campaign for introducing euro cash in the EMU member countries (including Finland). The recent experience of our northern neighbours in becoming a member of the EMU is highly valuable for Estonia. Another important topic of the seminar was the role of the economic research department in the central bank.

## CO-OPERATION IN THE AREA OF ECONOMIC RESEARCH

In 2001 Eesti Pank reinforced its international co-operation in economic research. Visiting researchers from France and the Netherlands were working at Eesti Pank; there were also several co-operation projects with other research institutions. On the initiative of Eesti Pank, a joint research was made for the first time with the Latvian and Lithuanian central banks – the research focused on the relationship between the real exchange rate and competitiveness in the three Baltic States. Other co-operation partners were the Ministry of Finance, the Research Institute of the Finnish Economy (ETLA), the UK National Institute of Economic and Social Research (NIESR), the Bank of England Centre for Central Bank Research and the International Centre for Economic Growth (ICEG).

Other events included **the seventh scientific seminar of the economic researchers of Eesti Pank**; international conference **Economic and Monetary Union: Challenges and Risks** held in Tartu and organised by Eesti Pank in co-operation with the University of Tartu, European College of the University of Tartu, Hansapank and Sampo Pank; international conference **Challenges for the Unified Financial Supervision in the New Millennium** organised by the Ministry of Finance, Eesti Pank and the World Bank; seminar **Introduction of Euro and Withdrawal of the National Currencies of the Eurosystem – What does it Mean for Estonia and Europe?** held in September; joint seminar of the Bank of England and Eesti Pank **Development of Strategy and Planning in Central Banks**; **statistical seminar of the central banks of the Baltic States**.