

ORGANISATION AND COOPERATION

INTERNATIONAL COOPERATION

The developments taking place in Estonia, a small and open economy, are normally closely tied to external processes. Thus, international communication claims a very significant place in the work of Eesti Pank. All the principal fields of activity of Eesti Pank are involved in international cooperation.

The **central bank's international communication framework** includes regular economic policy reviews of various countries and regions (especially EU Member States and Estonia's neighbouring countries), meetings to prepare for the meetings of EU committees and working groups and to obtain an overview of recent developments, management of the external communication database, etc. Prior to sessions of high-level bodies, briefings are held where experts from different departments discuss relevant information, specify the national positions and proposals for comments with the central bank representatives attending such sessions.

Communication with various European institutions and participation in EU meetings constitute the largest share of Eesti Pank's external communication and provide an additional dimension to cooperation with the central banks of Estonia's neighbouring countries. The central banks of the Nordic and Baltic States have held a special place among the communication partners of Eesti Pank for nearly fifteen years already. Traditional cooperation seminars and bilateral meetings, such as the joint seminar of the Baltic central banks, and a high-level seminar with the Bank of Finland, were held also in 2006.

Regular cooperation with the European Union institutions

Eesti Pank's representatives participate in around seventy committees and working groups set up by the European System of Central Banks (ESCB), the Council of the European Union or the Council of Ministers and the European Commission (see Table 1). In 2006, Eesti Pank's executives and experts participated in about 300 meetings in various

Table 1. Eesti Pank's participation in the work of international organisations and institutions

Cooperation bodies of the Council of the European Union	<ul style="list-style-type: none"> • Informal Council of Economics and Finance Ministers • Economic and Financial Committee
Cooperation bodies of the European Commission	<ul style="list-style-type: none"> • European Banking Committee • Committee of European Banking Supervisors • Committee on Monetary, Financial and Balance of Payments Statistics • Balance of Payments Committee
Cooperation bodies of the European System of Central Banks	<ul style="list-style-type: none"> • General Council of the European Central Bank • Accounting and Monetary Income Committee • Banking Supervision Committee • Banknote Committee • External Communications Committee • Human Resources Conference • Information Technology Committee • Internal Auditors Committee • International Relations Committee • Legal Committee • Market Operations Committee • Monetary Policy Committee • Payment and Settlement Systems Committee • Statistics Committee
International Monetary Fund (IMF)	<ul style="list-style-type: none"> • Board of Governors of the IMF • Nordic-Baltic Monetary and Financial Committee, incl. the Committee of Alternates • Meetings of coordinators of the Nordic-Baltic Constituency
Bank for International Settlements (BIS)	<ul style="list-style-type: none"> • Board of Governors of the BIS • Meetings of BIS central bank governors • BIS Monetary Policy Working Party • Meetings of Coordinators of Technical Assistance, organised by the BIS

EU institutions. Collaboration in committees and working groups provides a good opportunity to the Member States for discussing their political and expert views, enabling each participant to substantiate and clarify their standpoints.

European Central Bank

The European Central Bank (ECB), where euro-area monetary policy decisions are made, is the most significant cooperation partner for Eesti Pank in the EU. Eesti Pank is a full member of the European System of Central Banks.

Until Estonia has not adopted the euro, the main fields of cooperation are the economic policy of the EU, the monetary policy of the non-euro area countries, and preparations for the euro area enlargement, including the drafting of the so-called Convergence Report¹ – an account of meeting the euro area accession criteria. The Governor of Eesti Pank participates together with the governors of other EU national central banks (NCB) in the meetings of the ECB General Council, which take place four times a year. The day-to-day cooperation takes place in the thirteen committees of the ESCB and their substructures, where common analyses are composed, preparations for the work of the decision-making bodies – the Governing Council and the General Council of the ECB – are made by representatives of NCBs, and information is exchanged. The committees cover all the fields of activity of the central bank. In 2006, representatives of Eesti Pank took part in over 220 working meetings, which shows that cooperation is very close.

Role of Eesti Pank after the adoption of the euro

Until accession to the euro area, Eesti Pank is in charge of implementing Estonia's monetary policy,

arranging currency circulation, ensuring financial stability, and guaranteeing the operation of reliable and well-functioning payment and settlement systems. The goal is to ensure the stability of the economy and the Estonian kroon, which form the foundation of a strong state.

When the euro is put into circulation, the tasks of Eesti Pank will generally remain the same, but the international significance of the institution will increase, as Estonia starts to participate in the euro area financial policy making hand in hand with other national central banks and the ECB. Eesti Pank is currently responsible for ensuring the reliability of the Estonian kroon, whereas in the future, the central bank will be engaged in ensuring the reliability of the euro. As transition to the euro means that one currency will be replaced by another one, the issuer of the euro in Estonia will be Eesti Pank as agreed with the European Central Bank.

Eesti Pank will continue to perform all the tasks of a central bank in the Eurosystem. The objective of the euro area national central banks is to ensure price stability and to this end they implement the single monetary policy in the euro area. Eesti Pank will be participating in the monetary policy decision-making (e.g. fixing of interest rates), where Governor of Eesti Pank as a member of the Governing Council of the ECB² has the same role as, for example, the Governors of the Deutsche Bundesbank or Banca d'Italia.

Eesti Pank is already analysing the economic indicators of Estonia as well as the rest of the world. Euro area membership and participation in the euro area monetary policy decision-making means that the central bank will have to deepen and expand international economic analysis even further. As a

¹ See background information "Assessment of euro readiness in 2006: convergence reports" (p. 55) for an overview of the preparation and contents of the 2006 Convergence Reports.

² Since Estonia's accession to the EU, Eesti Pank has been taking part in the work of the so-called transition body or General Council of the ECB, where representatives of the NCBs of all EU Member States participate.



member of the euro area, Eesti Pank will participate in the joint management of reserves and development of settlement systems.

The central bank will maintain its important role in communication with other central banks and international organisations (e.g. the IMF, rating agencies).

Eesti Pank will be ensuring the smooth operation of payment and settlement systems also in the future so as to guarantee fast and efficient interbank transfers, contribute to the sustainability of the financial system, and compile Estonia's balance of payments.

Council of the European Union

Besides participating in the cooperation bodies of the European System of Central Banks, Eesti Pank's representatives also partake in the work of committees and working groups set up by the **Council of the European Union**, i.e. the Council of Ministers. For example, in April and September 2006, the Governor of Eesti Pank attended the informal meetings of the Economic and Financial Affairs Council (ECOFIN), where subjects of discussion included the European and international economic situation; issues related to the EU financial stability, such as harmonisation of the supervisory practices of the EU financial sector and financial crisis management; global competition, innovation and productivity, and formation of common positions for the annual meeting of the International Monetary Fund.

In addition, central bank experts advise the officials of the Ministry of Finance participating in the monthly ECOFIN meetings in matters within the competence of Eesti Pank. In 2006, such matters included implementation of the Maastricht price stability criterion; ensuring the sustainability of public finances against the background of ageing population; assessment of the Member States' economic policy; preparation and fundamental approval of the code of conduct for the EU securities payment

and settlement system; creation of the Single Euro Payment Area; cross-border mergers and acquisitions in the financial sector, and the financial services strategy until 2010.

One of the most important substructures of the Council of the European Union, where Eesti Pank's representatives participate, is the **Economic and Financial Committee** (EFC) and its working groups dealing with issues of international economy and coins. One of the main discussion subjects in 2006 was **implementation of the price stability criterion prescribed in the Maastricht Treaty**.

European Commission

Representatives of Eesti Pank participate in the Banking Advisory Committee, Banking Supervisory Committee, Balance of Payments Committee, and Committee on Monetary, Financial and Balance of Payments Statistics set up by the European Commission, as well as in working groups covering statistics, economic forecasting, payment systems, banking issues, issuance of banknotes and coins, counterfeit money, and communication.

Regular meetings take place with Commission experts twice a year in order to discuss Estonia's economic outlook and specify the forecast assumptions drawn up for all the Member States by the Commission.

In 2006, also separate meetings took place with Commission representatives to clarify Estonia's inflation mechanisms.

Cooperation with the International Monetary Fund

The International Monetary Fund (IMF) is a very important forum for international cooperation involving most of the countries in the world (185 to be specific). The main objectives of the IMF include ensuring the stability of the international monetary and financial system, supporting stable and sustainable economic growth and through this avoiding financial and balance of payments crises, and promotion

of international trade. Eesti Pank is responsible for representing the interests of Estonia in the IMF.

In 2006, the IMF approved of a new strategy, which brings along changes in both the day-to-day work in achieving the key objectives of the Fund and the ope-

rating principles of the organisation. A major part of the activities of the IMF is related to the **monitoring of the economic policies** of its member countries. Implementation of the new strategy of the IMF includes streamlining the policy and methods for monitoring.

SELECTION OF THE KEY TOPICS COVERED IN THE ECB MEETINGS IN 2006

Specifics of Estonia and other rapidly growing economies catching up with the average EU income level

It is important for Estonia to have the growth rate of its economy and the level of its inflation rate assessed against the background of a financial system having a currency-board-based fixed exchange rate regime and strong cross-border integration (primarily with Northern Europe). In the same way, it is vital these circumstances are taken into account when discussing the funding of Estonia's economic development.

In the meetings of ECB committees and working groups, experts of Eesti Pank took the opportunity to explain Estonia's economic developments and the balancing role of the currency board arrangement in the overall economic framework. They were also involved in analysing the economies of other non-euro area Member States and drew attention to the need to consider the general economic context, not just a few single indicators.

Using the economic processes of more prosperous countries as a comparison basis, it is often difficult to understand how the faster price growth and economic expansion of a country undergoing rapid development and convergence towards the EU average indicators (i.e. a country like Estonia) could be sustainable. In countries with relatively slow economic growth, the infla-

tion rate regarded to be in line with price stability implies a much more modest price growth than, for example, in Estonia.

In the case of countries that are rapidly catching up with the EU average, it would be much more expedient to assess the conformity of the inflation rate to price stability in the general economic context (taking into account also productivity growth) rather than merely compare the inflation indicators.

Economic policy framework ensuring the exchange rate stability and the flexibility of the economy and markets (incl. the labour market) within the exchange rate mechanism ERM II

The survey of the economic development of the ERM II member countries aimed at assessing their readiness to join the euro area.

Estonia has not encountered any difficulties during the time of participation in ERM II.

Relations between economic growth, capital inflow and inflation in countries with different exchange rate policies

Clarification of the objective and impact of the **financial policy measures taken by Eesti Pank** in 2006 (for further details see p. 33 "Ensuring financial stability").

SELECTION OF THE KEY TOPICS ON THE 2006 AGENDA OF THE COUNCIL OF THE EUROPEAN UNION

Economic situation in the European Union.

Eesti Pank's statements mainly concentrated on topics related to the economic policy of Estonia and other ERM II members, including long-term fiscal sustainability, inflation and structural policy, development in the credit and real estate market and its influence on the economy.

Euro area expansion. Assessment of the economic development in the countries' convergence reports and interpretation of the Maastricht criteria proceeded from that framework. It is in the interests of the entire EU that expansion of the euro area should take place in full compliance with the provisions of the Treaty establishing the European Community and according to uniform rules. Otherwise, the credibility of the euro as an international reserve currency would be compromised.

Supporting the uniform approach, Eesti Pank together with the Ministry of Finance actively participated in discussions on the economically meaningful interpretation of the Maastricht inflation criterion. In addition, at several meetings it was necessary to provide a detailed explanation about the fulfilment of the legal convergence criterion in Estonia. Consequently, by end-2006, Estonia was the first non-euro area Member State to meet all the legal requirements for the changeover to the euro.

Financial system stability in the European Union

In its statements and explanations Eesti Pank drew attention to the specifics of financial development in Estonia and similar EU countries, focusing mainly on the topics of strong credit growth and foreign currency loans. Reasons for growth and related risks were observed more closely.

Cross-border cooperation and division of tasks between financial supervision authorities in the European Union

Given the specifics of Estonia's financial system, it is especially important for the country to enhance cross-border cooperation in financial supervision (for further details see "Ensuring financial stability" p. 33).

EU financial services policy for the years 2005–2010.

Eesti Pank paid special attention to the preparations made for the development of single European capital market, including the elaboration of the Trans-European Securities Settlement System. Eesti Pank supported a framework based on agreements between market participants but also pointed out risks related to this solution (for further details see "Ensuring financial stability" p. 33).

Common position of the EU on issues of the International Monetary Fund (IMF)

Eesti Pank is responsible for the relations between Estonia and the International Monetary Fund. Therefore, in 2006 the central bank participated actively in various discussions on topics like IMF quotas and representation in the IMF and strengthening the monitoring of economic policy in the Member States. Eesti Pank was similarly involved in the spring and autumn meetings of the Monetary and Financial Committee, where common positions of the EU were determined.

Euro coins. Eesti Pank closely observed discussions related to the practice of acceptance and re-use of euro coins and to the issuance of collector coins and consulted in this respect the colleagues in the Ministry of Finance.

Statistics. For years, Eesti Pank has supported the development and application of best prac-

tices in the field of statistics. In 2006, the supervision of the application of the agreed code of conduct deserved special attention. Estonia considers it important to ensure consistent quality in statistics in all the EU Member States. In

addition, by means of providing specific priorities Eesti Pank supported efficient usage of resources for collecting, processing and publishing statistics (for further details see "Developments in statistics" p. 38).

Preparations to change the operating principles of the IMF are currently under way. The member countries decided at the Annual Meeting 2006 held in Singapore to **reform the system of quotas¹ and voting power²**. The aim is to simplify the formula used for calculating quotas, increase quotas for under-represented countries and also the role of basic votes³ which will bring about a change in the IMF Articles of Agreement. This presumes an approval from the parliament in several member countries including Estonia.

The Governor of Eesti Pank is a member of the highest decision-making body of the IMF, the **Board of Governors**, which makes him the Governor of Estonia, and the Secretary General of the Ministry of Finance is the alternate member of the Board of Governors making him the Deputy Governor of Estonia. Both members attend the IMF Annual Meeting every year. The **International Monetary and Financial Committee** (IMFC), the advisory board to the Board of Governors, meets twice a year (in April and September).

Day-to-day cooperation with the IMF is conducted first and foremost through the **Nordic-Baltic Constituency** representing inter alia Estonia. The Constituency includes eight countries (Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway and Sweden) that elect a common representative to the Executive Board of the IMF. As of January 2006,

the position of the Director of the Constituency has been held by a Finnish representative Tuomas Saarenheimo. To participate in the daily decision-making process of the IMF, the Constituency coordinates the positions of the eight countries on issues discussed in the Executive Board.

The strategic issues and related problems within the sphere of interests of the Nordic and Baltic countries are discussed twice a year in the Nordic-Baltic Monetary and Financial Committee (NBMFC). Each constituent country is represented in the Committee by a representative of the government and of the central bank. The experts daily involved in coordinating the work of the Constituency, i.e. the coordinators, meet once a year.

In 2006, the central banks of Estonia and Iceland prepared an analysis of the quality and efficiency of economic policy consultations in the Nordic-Baltic Constituency that are being carried out under Article IV of the IMF Articles of Agreement. A separate monitoring project was carried out by the IMF to analyse the close integration of the financial sector in the Nordic-Baltic region. The project included a seminar held in Tallinn. The results of the project were published in the first half of 2007.

In the framework of **cooperation in monitoring between the IMF and Estonia**, the representatives of the IMF made two visits to Estonia in 2006. In April,

¹ A quota has been established for each IMF member determining its participation (subscription) in the Fund in the form of Special Drawing Rights (SDR) calculated on the basis of a complex system of formulas, where mainly three indicators (GDP, reserves, and the volume and volatility of current account transactions) with different weighting are applied.

² The voting power of every IMF country depends on the number of basic votes and the size of the country's quota.

³ According to the Articles of Agreement, every IMF member country owns 250 basic votes.



the new Head of IMF Mission to Estonia, Franciszek Rozwadowski, made his introductory visit. In August, regular economic policy consultations were carried out under Article IV of the IMF Articles of Agreement. After a discussion in the IMF Executive Board in November 2006, the main report and a report dealing with special issues on the Estonian economy based on these consultations were published on the web sites of both the IMF and Eesti Pank. In 2007, the IMF mission to Estonia took place at the beginning of May.

Cooperation with rating agencies

Sovereign rating, more specifically the credit rating of a country, is an assessment by internation-

al (private) rating agencies of a country's capability and willingness to repay its long-term foreign liabilities by due date. Indirectly, sovereign rating reflects the reliability of a country's economy and economic policy. Sovereign rating largely determines the interest rate on foreign borrowing.

Since 1997 Estonia is being assessed by three main international rating agencies: Moody's Investors Service, Standard&Poor's and FitchRatings. Eesti Pank manages relations between Estonia and the rating agencies. This includes rating agencies' visits once a year and day-to-day communication with the analysts.

SELECTION OF TOPICS FROM THE INTERNATIONAL MONETARY FUND FORUMS IN 2006

Economic developments in the new European Union Member States

One of the topics was clarification of the specifics of economic developments in Estonia and other rapidly growing countries that are catching up with the average living standard in the European Union. Inflation and current account developments in countries with fixed exchange rate were similarly explained.

Eesti Pank has discussed these questions with the IMF analysts, has submitted regular statements for the IMF World Economic Outlook but also concerning specific research papers of the IMF, and has invited the IMF representatives to introduce their positions on topics related to the economic policy in Estonia. In June 2006, Susan Schadler, the Deputy Director of the IMF European Department, gave a presentation in Tallinn on the growth outlooks for the Central and Eastern European countries.

New strategy approved by the IMF in 2006

The distribution of the IMF quotas and voting power is an important issue for Estonia. The cur-

rent quota for Estonia is approximately 80% lower than it would be according to the quota formula. The ongoing discussion on increasing the role of basic votes also supports strengthening the voting power of smaller and less advanced countries.

Changes in the principles of funding IMF's administrative costs

The planned changes may bring about the establishment of principles that differ from those used so far in obtaining funds from the member countries. As a member of the Nordic-Baltic Constituency, Estonia has supported zero per cent real growth of the Fund's budget and a more transparent funding of different fields of activity.

Economic policy monitoring in member countries

In the near future, a number of changes are about to be made that will have an impact on the relations between the IMF and all the member countries. For Estonia, it is important how external stability will be defined when changing the basis for exchange rate policy surveillance. Moreover, the questions whether and how the

medium-term objectives of the surveillance policy will be established and what kind of changes will be made in order to update financial sector surveillance are of significance.

Crisis prevention

In 2006, quite a lot of time was spent on the desires stemming from emerging markets to sup-

plement the Fund's list of credit lines with a large instrument enabling to support crisis prevention. Estonia considers it important that only countries with strong economic policy could use the credit line and that financial aid from the Fund would be made available as fast as possible if necessary.

COOPERATION WITHIN ESTONIA

Experts and executives of Eesti Pank participate in different cooperation bodies in Estonia (see Table 2).

The quarterly four-partite meetings held on Eesti Pank's initiative where officials of the central bank, the Ministry of Finance, the Ministry of Economic Affairs and Communications and the Prime Minister's Office discuss various topical issues of economic policy, such as the economic situation, developments in the real estate market, budget strategy, financial stability, labour market situation, etc., serve as an example of high-level internal cooperation.

The presidency of the European Union changes every six months. This affects also the **national coordination of EU-related activities** since national policy priorities and short-term objectives are always determined for the new presidency period. The Government's long-term objectives are established in the three-year framework programme to achieve Estonia's general objectives

in the European Union. For the national coordination of participation in the EU decision-making process the European Union Coordination Council has been set up. Eesti Pank participates in the work of that council. The council deals with the coordination of the transposition of European Union legislation; the discussion of EU-related positions submitted to the Government; solving problems between various state agencies, and exchange of information on EU-related matters.

In order to participate in external working groups the experts of Eesti Pank usually meet at the **seminars and brainstorming sessions** organised by the bank. For example, the competitiveness of the Estonian economy was discussed at the spring seminar of 2006 in Kuressaare and trends in the real estate market at the autumn seminar in Jämeda.

Cooperation with the Office of the President

Members of the Executive Board of Eesti Pank have accompanied the President of the Republic during state visits at several occasions. In 2006, such visits were paid to Latvia, Georgia and Portugal. The

Table 2. Eesti Pank's participation in internal cooperation

- European Union Coordination Council
- Lisbon Working Group
- Working Group on Financial Services Legislation
- Coordination committee for the prevention of money laundering
- Inter-agency support unit for the Intergovernmental Conference
- Development Cooperation Working Group
- National Coordination Working Group of the Organisation for Economic Cooperation and Development (OECD)
- National Coordination Working Group for the preparation of the Treaty of Accession for Bulgaria and Romania
- Working group for the development of national positions for representing Estonia in the European Commission, the European Court of Justice and the Court of First Instance
- Working group for the future enlargement of the European Union



speeches held by the central bank representatives during state visits are available on the web site of Eesti Pank.

Cooperation with the Ministry of Finance

In addition to daily cooperation in the elaboration of legislation, international communication and in other fields, a joint seminar of Eesti Pank and the Ministry of Finance was organised in 2006. Representatives of both institutions presented their views on Estonia's economic outlooks and introduced surveys related to fiscal and taxation issues and the real estate market. The last such joint seminar was held three years ago. Both institutions find that such a dialogue should be initiated at least once a year.

Cooperation with the Financial Supervision Authority

At the end of 2006, Eesti Pank, the Financial Supervision Authority and the Ministry of Finance concluded a Memorandum of Understanding (MoU). The MoU sets out the distribution of responsibilities between state agencies in financial crisis management. National crisis management cooperation agreements are an integral part of the EU crisis management framework.

Close cooperation with the Financial Supervision Authority operating by Eesti Pank has focused on monitoring financial system developments, discussions related to regulations of the financial sector and, to a large extent, also on international cooperation. In the latter case cooperation between Eesti Pank and the Financial Supervision Authority is similar to that between the central bank and the Ministry of Finance: if necessary, joint preparations are made for meetings with foreign experts (e.g. officials from the International Monetary Fund or rating agencies) or for participation at meetings of EU institutions.

Cooperation with the Estonian Banking Association and Estonian banks

Regular meetings with members of the Estonian Banking Association, i.e. high-level representatives of commercial banks operating in Estonia, form a basis for cooperation and information exchange with the private sector. Even more often experts of commercial banks meet with representatives of Eesti Pank in order to specify the technical issues related to the development of the Estonian banking infrastructure. Cooperation in the field of payment and settlement systems should be pointed out here.

ASSESSMENT OF EURO READINESS IN 2006 – CONVERGENCE REPORTS¹

In spring and winter 2006, the European Commission and the European Central Bank assessed a number of EU Member States² with regard to their readiness to adopt the single currency euro and the single monetary policy. The assessment is based on the provisions of the Treaty on European Union or the so-called Maastricht criteria. The fulfilment of these criteria demonstrates the suitability of the econo-

mic situation, economic policy and legislation of a country for the euro changeover. In other words, they show whether the situation in these fields is sufficiently similar to that of the euro area.

Based on these assessments – the Convergence Reports – the European Commission presents its opinion on which countries are ready to join the euro area to the Council of Economic and

¹ Convergence Reports are available at the European Commission's web site http://ec.europa.eu/economy_finance/publications/convergencereports_en.htm and the European Central Bank's web site <http://www.ecb.int/pub/convergence/html/index.en.html>.

² The Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia, and Sweden.

Financial Ministers (ECOFIN) and the European Council. The only country that was assessed to be ready to join the euro area was Slovenia where the single currency was adopted in January 2007.

The convergence reports are drafted on the basis of the Maastricht criteria, the fulfilment of which should guarantee the smooth functioning of the Economic and Monetary Union, including the possibility to maintain a stable price level through the single monetary policy.

An environment of Economic and Monetary Union that enables to maintain price stability can be characterised by the following:

- Strict fiscal policy (general government budget deficit must not exceed 3% and debt 60% of GDP);
- Low inflation rate (must not be more than 1.5 percentage points above the average annual inflation rate³ of the three EU Member States with the lowest interest rates);
- Low long-term interest rate (the interest rate of long-term government bonds must not exceed the average of the three EU Member States with the lowest interest rates by more than 2 percentage points);
- Stable exchange rate observed at least for two years when the country has been participating in the exchange rate mechanism ERM II.

The necessary legal prerequisites mainly relate to the compatibility of central bank's objectives with the ECB's objectives and central bank's independence.

The euro readiness of Lithuania and Slovenia was assessed in spring 2006 and that of the rest

of the non-euro area countries in autumn 2006. By the time of assessment Slovenia had fulfilled all the criteria. However, Lithuania was confronted with an obstacle of slightly higher inflation than allowed – the inflation criterion was 2.6% in spring 2006, but in Lithuania the average annual price rise was 2.7%. Lithuania's non-qualification brought about an active discussion in the EU on the appropriateness of the inflation criterion in principle in assessing price stability in rapidly growing economies. Since no common position was reached, it was preferred to continue with the old criterion in order to guarantee equal treatment of countries that have joined the euro area at different points of time.

Table a gives an overview of the results of the Convergence Reports of autumn 2006. The figures with pink shading indicate compliance with the criterion. In autumn, also Estonia was assessed, and the country appeared to fulfil the criteria the most: all requirements except for the inflation criterion were satisfied. Estonia's average annual inflation rate reached 4.3% in autumn 2006.

The next candidates to join the euro area are Cyprus and Malta. Their Convergence Reports were published in May and the decision is made in summer. By that time these two countries have presumably met all the requirements, including the two-year participation in ERM II.

ISSUES RELATED TO THE DATE FOR THE ADOPTION OF THE EURO

Owing to rapid inflation the initial date for the adoption of the euro – 1 January 2007 – became more questionable in spring 2006. Since the introduction of the euro is of great importance to the public, the issue of setting the transition

³ This inflation rate is not directly comparable to the inflation rate regularly published by Statistics Estonia due to differences in calculation methods.

date had to be made as clear as possible. To this end, forecasts of various institutions, such as the Ministry of Finance, Eesti Pank and the European Commission, were proceeded from. The spring forecast of Eesti Pank published at the end of April gave hope that Estonia would fulfil the Maastricht inflation criterion in the first half of 2007. In addition, the Government postponed the deadline until 1 January 2008. The public was immediately notified of that.

The forecast of the Ministry of Finance published on 22 August showed that Estonia's inflation rate was higher than expected. Andres Lipstok, Governor of Eesti Pank made a statement back then, saying that the consumer price increase hinders Estonia to join the euro area in 2008 and

that adopting the euro as soon as possible had remained the objective of the Government and the central bank.

On 8 November a new autumn forecast was introduced by Eesti Pank. The presentation of the forecast clarified many aspects regarding the adoption of the euro (a clear signal was given to the public that 2008 and possibly also 2009 were not an option anymore). Shortly, the Government also confirmed that the objective is to join the euro area as soon as possible; however, a clear date was not set. In any case, the exact date of the euro changeover will be known at least twelve months in advance before the changeover, so that the state and the private sector could finish necessary preparations.

Table a. Results of the Convergence Reports drafted in autumn 2006

Country	Inflation (2,8%)	Long-term interest rate (6,2%)	Exchange rate (incl. ERM II)	General government budget (up to -3% of GDP)	General government debt (60% of GDP or declining)	Legislative conformity
Estonia	4.3%	4.1%	Yes (28.06.04)	+2.3%	4.5%	Yes
Cyprus	2.3%	4.1%	No (02.05.05)	-2.3%	69.2% ↓	No
Lithuania	2.7%*	3.7%**	Yes (28.06.04)	-0.5%	18.7%	Yes
Latvia	6.7%	3.9%	No (02.05.05)	+0.1%	12.1%	No
Malta	3.1%	4.3%	No (02.05.05)	-3.2%	74.2% ↓	No
Poland	1.2%	5.2%	No	-2.5%	42.0%	No
Sweden	1.5%	3.7%	No	+2.0%	50.4%	No
Slovakia	4.3%	4.3%	No (28.11.05)	-3.1%	34.5%	No
Slovenia	2.3%*	3.8%**	Yes (28.06.04)	-1.8%	29.1%	Yes
Czech Republic	2.2%	3.8%	No	-3.6%	30.4%	No
Hungary	3.5%	7.1%	No	-7.8%	61.7% ↑	No

* At the time of drafting the reports on Lithuania and Slovenia the inflation criterion was 2.6%.

** At the time of drafting the reports on Lithuania and Slovenia the long-term interest rate criterion was 5.9%.

PUBLIC RELATIONS AND COMMUNICATION

The main objective of central bank communication is maintaining relations with financial markets and other important target groups. Markets observe central bank communication and shape their expectations according to the relevant messages.

Eesti Pank is a central bank that operates in the framework of the currency board system with a fixed exchange rate. The objective of central bank communication is to support with its messages the stability of Estonia's monetary system, economy and financial system. The strategic objectives of the bank and the organisation's understanding of the central bank's role form the basis for communication.

The communication policy of Eesti Pank **proceeds from the following objectives:**

- To ensure public understanding of and sufficient support to the monetary policy pursued by the central bank;
- To maintain and value the reputation of Eesti Pank as a competent, independent, and credible institution that plays a significant role in guiding Estonia's economic policy and economic development, whose activities are transparent and controllable, and that is willing to communicate with all social groups;
- To ensure the best possible access for economic agents to background information necessary for making economic decisions.

Principles of informing the public

Transparency and reliability are vital in the central bank's activities. The general public but also more specific target groups, both domestic and foreign, must be able to receive regular, sufficient and high-quality information on economic policy from Eesti Pank. The central bank considers it important to provide as up-to-date information as possible in the most convenient and the least expensive way. For example, Eesti Pank's regular publications are free of charge for subscribers and among others all the county libraries receive them. In addition to various publications and information published on the web site, it is possible to send direct inquiries to Eesti Pank. Information can be requested by mail, e-mail or phone. In 2006, Eesti Pank received 3,074 inquiries, 172 of which were registered as requests for information.

Media relations and public appearances

Approximately 3,500 writings, news texts, radio and TV news reflecting the activities of Eesti Pank and its economic policy standpoints were published or released in the Estonian media in 2006. The central bank held 7 press conferences, issued 54 press releases and a large number of statements. Moreover, 17 articles were published.

Both, the domestic and international media were mainly interested in the adoption of the euro and

economic developments in Estonia. Strong credit growth remained on the agenda. Eesti Pank repeatedly called for vigilance in this respect. At the end of the year, Eesti Pank paid more attention to consumer credit since their growth had increased significantly. Opinions of the IMF and rating agencies on the Estonian economy but also labour market issues similarly deserved a lot of attention.

In November, Eesti Pank informed the media about joining the euro area settlement system TARGET, which enables customers of banks and other financial institutions to make fast and secure euro payments in the European Union via Eesti Pank.

During the year, central bank representatives made presentations at a number of conferences and events on the topic of changeover to the euro and the economic situation in Estonia.

On 9 September, the fifth Open Door Day of Eesti Pank took place with the focus on wisdom in monetary affairs. The objective was to provide visitors with practical information on monetary issues as well as entertainment. Economists of Eesti Pank held a lecture on the risks related to borrowing to make people aware of various aspects to be considered when taking a loan.

Just before the Open Door Day, Eesti Pank participated in an art project "Houses, show what you've got inside!" organised in the framework of a drawing exhibition "Improvisation". During one night the portraits of Lydia Koidula and Carl Robert Jakobson were projected on the façade of Eesti Pank by artists Flo Kasearu and Alide Zvorovski.

Communication on the euro

In 2006, Eesti Pank together with representatives of other state institutions and the private sector continued with preparations in the field of communication on the changeover to the euro. The communications working group under the expert committee for the euro changeover, which was established in 2004 by the Government for guaranteeing a smooth



adoption of the euro, had regular discussions on the issues related to informing the public and updated the communication action plan. Technical preparations for starting the euro campaign continued at the beginning of 2006. As the year moved on, the date for the adoption of the euro deserved more and more attention and consequently had to be treated in the communication by the state.

Seminars and presentations on the euro held in various locations in Estonia by central bank and Government representatives were extremely popular. Altogether 51 events were organised with the audience varying from school children to the elderly. The topics covered focused on the advantages of the euro changeover, whereas speakers tried to mitigate the fears accompanying the single currency. People are mostly afraid of a possible price increase.

All kinds of printed materials form an important part of the euro campaign. In cooperation with the European Central Bank and the European Commission, Estonian state institutions distributed publications on the single currency aimed at different target groups. In summer, the brochure "Hello, euro!" reached Estonian newspaper subscribers. The main objective of the materials distributed in 2006 was to introduce the birth of euro as the single currency of Europe and the visual appearance of banknotes and coins, and to give an overview how the changeover would be organised in Estonia. The topics covered included also the advantages and disadvantages of the introduction of the euro.

At the beginning of 2006, a special edition dealing with the topic of the euro, *The Ajaleheleht*, was published as a joint project of Eesti Pank and the Estonian Newspaper Association. This project, initiated by the Estonian Newspaper Association, aimed to promote reading newspapers and develop critical reading among the young. Every issue dealt with a specific topic. The newspaper was published in Estonian and Russian and included serious as well as entertaining stories on the euro.

Interviews featured also various well-known public figures. The Estonian Newspaper Association and Eesti Pank introduced the project to teachers at seminars all over Estonia.

In February, a special web site dedicated to the euro was launched (euro.eesti.ee). The web page is compiled and developed by Eesti Pank. However, the concept and technical platform of the site enables also other state institutions to make their contributions. The first months of the euro web gave a lot of feedback and many inquiries had to be answered.

GOVERNANCE, ORGANISATION AND PERSONNEL POLICY

Eesti Pank's governing bodies and decision-making processes

Supervisory Board of Eesti Pank

Pursuant to the Eesti Pank Act, the **Supervisory Board of Eesti Pank** is the highest body of Eesti Pank, exercising supervision over all the activities of the central bank. The Supervisory Board of Eesti Pank has the exclusive competence in the following issues:

- making a proposal to the President of the Republic for appointment of the Governor of Eesti Pank;
- Appointment to office and release of the Deputy Governors of Eesti Pank, the heads of the independent divisions and representative offices and Head of the Internal Audit Department of Eesti Pank, as well as the two members of the Supervisor Board of the Financial Supervision Authority¹ appointed by Eesti Pank on the proposal of the Governor of Eesti Pank;
- approval of the statutes of the independent divisions and representations of Eesti Pank ;
- supervision of the implementation of the budget of Eesti Pank;
- Appointment of the internal auditors of Eesti Pank and approval of the internal audit work schedule;
- Appointment of the independent auditors of Eesti Pank; approval of Eesti Pank's Annual Report on the proposal of the Governor;
- Decision-making regarding the denomination and design of new banknotes and coins;
- Deciding upon the establishment, reorganisation and liquidation of the independent divisions of Eesti Pank on the proposal of the Governor;

- Review and approval of written proposals and other documents submitted to the Riigikogu in the name of Eesti Pank.

The Governor of Eesti Pank reports regularly to the Supervisory Board on the situation in Estonia's economy, monetary policy and financial sector as well as on the implementation of the central bank's budget.

On 17 February 2004, the Riigikogu appointed to office the current Supervisory Board of Eesti Pank, comprising Professor **Mart Sörg** (Chairman of the Board, appointed to office on 12 June 2003), Faculty of Economics of the University of Tartu; Professor **Raul Eamets**, Faculty of Economics of the University of Tartu; Professor **Enn Listra**, Dean of the Faculty of Economics of the Tallinn University of Technology; **Mart Opmann**, Member of the Riigikogu; **Tõnis Palts**, politician and businessman; Professor **Jüri Sepp**, Faculty of Economics of the University of Tartu, and **Liina Tõnisson**, Member of the Riigikogu. After Andres Lipstok assumed the office of Governor of Eesti Pank on 7 June 2005, one position in the Supervisory Board remained vacant until 24 January 2006 when **Harri Ōunapuu** was nominated as an alternate member.

From 7 June 2005 to 8 July 2006 also **Andres Lipstok**, Governor of Eesti Pank belonged to the Board by virtue of office, but pursuant to the Eesti Pank Act Amendment Act that entered into force on 8 July 2006 the Governor is no longer a member of the Board.

Governor of Eesti Pank

On 10 May 2005, the Supervisory Board of Eesti Pank elected Andres Lipstok as candidate for the position of Governor of Eesti Pank and made a pro-

¹ The Supervisory Board of the Financial Supervision Authority comprises six members: two of them – the Minister of Finance and the Governor of Eesti Pank – are members by virtue of office while four are appointed. The Board is chaired by the Minister of Finance. Half of the members are appointed and removed by the Government of Estonia on the proposal of the Minister of Finance and half by the Supervisory Board of Eesti Pank on the proposal of the Governor of Eesti Pank.



posal to the President of the Republic of Estonia to nominate Andres Lipstok as Governor of Eesti Pank. The President appointed Andres Lipstok to office on 18 May 2005. **The new Governor of Eesti Pank commenced his duties on 7 June 2005.**

Executive Board of Eesti Pank

Pursuant to the Eesti Pank Act, the Executive Board of Eesti Pank is responsible for planning and organising the central bank's activities. The Chairman of the Executive Board by virtue of office is the Governor of Eesti Pank. In 2006, the Executive Board comprised **Governor Andres Lipstok** and **Deputy Governors Rein Minka, Märten Ross** and **Andres Sutt**.

Governor **Andres Lipstok** is in charge of the **overall governance** of the activities of Eesti Pank. His exclusive competence involves organising the designing of monetary and banking policies and the overall governance of the activities of Eesti Pank; supervision of the enforcement of the decisions

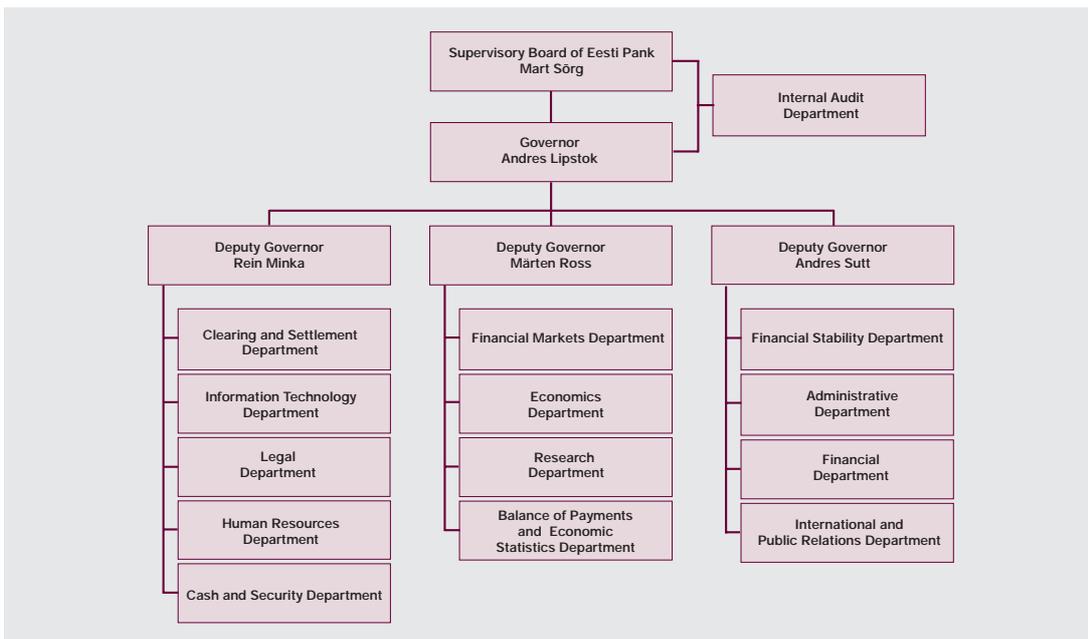
passed by the Supervisory Board and implementation of measures necessary for that purpose; approval of Eesti Pank's budget, and supervision of the execution of the tasks of the European System of Central Banks.

The Governor reports to the Riigikogu and responds to interpellations concerning Eesti Pank's activities submitted. The Governor regularly reports on his activities to the Supervisory Board of Eesti Pank.

The Governor controls the work of Deputy Governors and is responsible for supervising management mechanisms.

Deputy Governor Rein Minka is responsible for coordinating the activities related to currency circulation; safety of the working environment; reliable, cost-efficient and integrated development of the settlement system of Eesti Pank; development of the information technology working environment and legal environment, as well as personnel management.

Figure 1. Organisational chart of Eesti Pank as at 31 December 2006



Deputy Governor Andres Sutt is responsible for international and public relations of Eesti Pank; development and implementation of financial sector policies; coordination of collection, handling and disclosure of financial sector information; supervision of payment and settlement systems, as well as for financial accounting and reporting, internal administrative services, and operational working environment at Eesti Pank.

Deputy Governor Märten Ross is responsible for the preparation and implementation of monetary policy decisions; management of the financial assets of Eesti Pank; coordination of collection, compilation, and disclosure of national statistics, and for the coordination of economic research and activities related to in-service economic training.

Monetary Policy Committee

A standing Monetary Policy Committee has been established to develop positions on monetary, economic and financial policies and coordinate the activities of Eesti Pank.

In 2006, the **Monetary Policy Committee of Eesti Pank** included the member of the Executive Board **Governor Andres Lipstok**, Deputy Governors **Rein Minka**, **Märten Ross** and **Andres Sutt** as well as **Janno Luurmees**, Head of the Financial Markets Department, **Ilmar Lepik**, Head of Economics Department (until 8 November 2006), **Tanel Ross**, Head of the International and Public Relations Department, **Rait Roosve**, Head of the Cash and Security Department, and **Sven Meimer**, Head of the Financial Stability Department.

Financial Supervision Authority

The **Financial Supervision Authority**² operates as an agency of Eesti Pank. The objective of the Financial Supervision Authority is to enhance the stability, reliability, transparency and efficiency of

the Estonian financial sector, to reduce systemic risks and to promote prevention of the abuse of the financial sector for criminal purposes. The objective of financial supervision is to protect the interests of clients and investors by safeguarding their financial resources, and thereby supporting the stability of the Estonian monetary system.

The Financial Supervision Authority is governed by the Management Board chaired by Raul Malmstein. The activities of the Supervision Authority are planned by the Supervisory Board chaired by the Minister of Finance by virtue of office – by Aivar Sõerd as at the end of 2006. Members of the Supervisory Board include Governor of Eesti Pank Andres Lipstok and Deputy Governor Andres Sutt.

DEVELOPMENT OF THE MANAGEMENT SYSTEM AND WORK ORGANISATION OF EESTI PANK IN 2006

Strategic management

Eesti Pank followed the strategic management development path opted for in 2001, which involves description of the bank's development priorities and regular tasks in a three-year perspective and more precise planning of human and financial resources. In 2006, more attention was also paid to process-based budget drafting. The development of the bank's management system, particularly the recording of the usage of working time by employees, has contributed to more precise planning of required labour.

In 2005, the Executive Board approved **Eesti Pank's management system** that associates different management activities, defines the relations between these activities as well as the persons responsible for them. In 2006, the integral introduction of the management system continued. No new development works were started to allow time for

² See Section 4 of the Financial Supervision Authority Act.



adjusting to innovations. Preparations were made to introduce the elements of value-based management in the management system and first related events took place, involving the whole bank. Larger developments in that field are planned for 2007.

Financial and management accounting was developed further. At the beginning of 2006, the bank started to use the financial accounting and reporting standards obligatory for the central banks of the Eurosystem. Furthermore, the controller's function was established to monitor sustainable and efficient use of resources and submit data supporting management decisions.

For already six years now the bank has been conducting appraisal interviews. The purpose of interviews is to review and plan work and development tasks in cooperation between the executives and the staff, and to receive proposals from the personnel regarding bank's strategic directions and organisation of work.

Process management

In 2006, no major developments were carried out in the bank's process management. The focus was rather on the enhancement of the existing processes and better integration of regular improvements with the management system of Eesti Pank.

During the audit Bureau Veritas Eesti OÜ validated the ISO 9001:2000 Quality Certificate issued to the Cash and Security Department in 2002. The certificate serves as a proof that cash handling and security processes in Eesti Pank are compliant with the requirements set forth in the standard.

Risk management

Eesti Pank has launched a risk management system comprising all the bank's functions and aiming at reducing the adverse impact of accidental events on accomplishing bank's objectives. In order to better organise risk management in the bank, the Executive Board approved the **risk management framework** and hired a full-time **risk manager** in 2006.

The central bank has introduced a two-level risk management system. At the strategic level, decisions are made regarding the bank's risk profile across processes, departments, risk classes and major risks. Strategic risk management aims at drafting a long-term plan for changing the risk profile of Eesti Pank. This plan should serve as the basis for improving the bank's strategic plan and making tactical decisions.

At the tactical level, decisions are made with regard to implementing concrete risk management measures in units.

A more in-depth risk mapping takes place twice a year when all the bank's units submit their reports on the materialisation of risks. The first such reports were submitted in the second half of 2006. The risk manager analyses the level of risks on the basis of these reports and, if necessary, together with the heads of units and specialists adjusts the assessments on the likelihood and impacts of the materialisation of risks.

The full risk management process is conducted once a year simultaneously with the strategic planning cycle. The inputs necessary for mapping and hedging risks include a regular overview of processes and audit reports.

e-Eesti Pank 2006

The year 2006 saw further implementation of the development strategy for document and information management (e-Eesti Pank) approved in 2003. The aim of e-Eesti Pank is a stage-by-stage changeover to e-administration and building up a document creation and document management system compliant with the best international experience in a common integrated environment.

In 2006, the following developments were made in the field of document, information and records management:

- Implementation of digital work flows in order to record, deliver and process the decisions and

orders of the Governor, the Executive Board and internal audit;

- Conduct of the risk analysis of records management and presentation of results;
- Arrangement and updating of the structure and metadata of document registers;
- Preparation of a business process based structure for the e-files of Eesti Pank;
- Creation of additional document search options for e-files;
- Introduction of an application for the management of the life cycle of e-documents.

As a result, the records management of Eesti Pank became faster and more transparent. Furthermore, procedures became more expedient and resources were used more effectively.

Renovation of the building of Eesti Pank at Sakala 6

In order to guarantee the safety of the communication and IT systems of Eesti Pank and the logistics of the transport of cash, the Executive Board decided to organise the renovation of the building at Sakala 6 according to the design of the architectural firm Arhitektuuribüroo Schults ja Partnerid OÜ. AS Merko Ehitus won the construction tender. The renovated building comprises 1,647 square metres of office space and technical space prepared for the adoption of the euro.

EESTI PANK'S PERSONNEL POLICY

The objective of Eesti Pank's personnel policy is to ensure the recruitment of employees needed for accomplishing the main objectives of the bank, to develop and train as well as motivate and provide fair pay to the staff.

Employees

Internal competition is preferred in **recruitment** in order to motivate the staff by providing horizontal career opportunities within the bank. External competition is used in case internal competition has failed or in case an employee with different expe-

rience is looked for. When recruiting for executives or other highly responsible posts, a competency model is used that provides the best opportunity to evaluate candidates' knowledge, skills, and personal characteristics.

The **payment of staff** derives from the need to recruit and retain highly competent staff and motivate them to work effectively and contribute to the good reputation of the bank. The average pay should be competitive in the labour market where the bank competes for employees. Generally, it means the financial sector labour market in Tallinn.

When determining the pays of the top management, the Supervisory Board of Eesti Pank takes into consideration top executives' wages in state and private enterprises with turnovers larger than 500 million kroons. The size of the pays of top executives is affected by changes in the wage market data in the financial sector of Tallinn and its vicinity. The pay of the Governor of Eesti Pank should not be smaller than the average wages of top executives in comparable enterprises and agencies.

In 2006, the total pays (basic wages and additional pay) of the members of the Supervisory Board amounted to 2,006,164 kroons and those of the Executive Board to 5,444,714 kroons.

Non-executive jobs have been evaluated on the basis of the Hay method. Depending on the evaluation results, all jobs have been divided into wage groups listed in the classification of central bank jobs. Eesti Pank has implemented a pay scale comprising a number of pay grades. The employees (members of the Executive Board excluded) get paid on the basis of their pay grade, comparable by groups of similar work within as well as outside the bank.

In 2006, the average monthly wage of a specialist stood at approximately 19,600 kroons.

At the beginning of 2006, the bank had contracts of employment with 255 employees (233 were actually



working, as contracts with 22 employees had been suspended), whereas at the end of the year the respective figure was 259 (238 were actually working and 21 contracts had been suspended). The main reasons for suspending contracts of employment were maternity leave, work at the European Central Bank or other international organisations.

The **average age** of the staff in 2006 was 41 years. The employees included 106 men (42%) and 149 women (58%).

Development and training

In 2006, a range of **internal training projects and seminars** was carried out.

The **training costs** accounted for **3.4% of the payroll**. The training costs per employee were 13,750 kroons (incl. travel expenses). In 2006, 196 employees attended training, which comprises 82% of the total staff. Training totalled 14,083 hours, an average of **seven days of training per employee**.

The main training topics in 2006 were defined in the bank's internal training plan. Departments were independent in determining their internal training needs.

All in all, the staff participated in **205 training events**, whereas 42% of them were held abroad. There were nine internal training courses, including seven in associated areas (management, communication, information technology and law) and two in core areas (economic theory and policy).

The key training topics included **management and communication aspects, economic theory and policy**, and **financial stability**. **Language training** remained popular, whereas besides English also German, French and Spanish are gaining popularity.

45 employees were engaged in **academic studies** in 2006: about half of them were acquiring the

Master's degree (23), a third the Doctor's degree (15) and the rest the Bachelor's degree. One employee participated in a secondment programme at the European Central Bank and another was a secondee at the Finnish central bank. Two employees from the Ministry of Finance were trainees at Eesti Pank for two months, participating in the economic forecasting process.

Hobbies and traditions of the staff

At the end of 2006, Eesti Pank's **Sports Club** had 221 members. Swimming, basketball, aerobics, gym, track and field, and volleyball were the most popular fields of sport. The staff also practices cycling, skiing, sailing, orienteering, chess, bowling and football. Furthermore, employees of Eesti Pank participated in several sport events held for the European national central banks, including a chess tournament in Belgium and an orienteering competition in Latvia.

The chamber choir of the employees of Eesti Pank and the Financial Supervision Authority first gathered on 15 May 1998. The choir has nearly 30 members and is conducted by Peeter Perens. Its activities are coordinated by the board which is elected every year.

In spring 2006, the chamber choir participated in the 9th Estonian Chamber Choir Festival in Viljandi and in autumn it took part in Eurochoir 2006, the festival of European national central banks. At Christmas, a concert was held at the Swedish St. Michael's Congregation in Tallinn.