EU Opinions –
The Qualifying Round for Applicants

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1 Introduction

The long-lasting approximation process has reached a new stage with the publication of Agenda 2000, which includes the Opinions of the European Commission on the membership applications of the ten Central and Eastern European countries (CEECs) and a reform package for the EU.[2]) This process had important cornerstones in the Copenhagen and Essen Summits of June 1993 and December 1994.[3]) The Agenda 2000 documents were presented to the European Parliament and the EU Council (at the Coreper level) on July 16, 1997. The European Commission recommended starting accession negotiations with *the Czech Republic, Estonia, Hungary, Poland and Slovenia.*[4]) Enlargement negotiations are scheduled for early 1998 with Cyprus, to whom this commitment had already been given. The Commission prepared its Opinion on Cyprus already in 1993. The Opinions on each applicant are an assessment of how far each candidate meets the criteria established by the Copenhagen European Council, where it was decided that the associated countries have to fulfill certain political and economic criteria and adopt and implement the EC *acquis communautaire*[5]) to become members of the European Union.

The recommendation of the Commission is not a binding proposal, because only the European Council can take the final decision about when, and with which countries, it will begin accession talks. Therefore, alternative conceptions of accession scenarios are currently being discussed among the EU Member States, such as simultaneous negotiations from a common point of departure for all ten applicants, or an invitation to all ten applicants to participate in an "open race" in which candidates can overtake each other. The final decision is likely to be taken at the Luxembourg Summit in December 1997. However, it has to be stressed that a common starting point in the accession negotiation process does not mean that there will be a common ending date as well. Consequently, any kind of differentiation between the applicants is not automatically tantamount to an exclusion from the process. The Commission proposes the annual presentation of a so-called "progress report" to the European Council on the further achievements of each applicant.[6]) Thus according to the Commission, countries not included in the first wave would nevertheless retain the prospect of starting accession talks as soon as they have made sufficient progress towards meeting the Copenhagen criteria.

The publication of the Opinions by the Commission is especially important, as they represent the first instance in which an EU body has compared the performance of transition countries along the same lines. Moreover, accession has a strong political dimension, which the Opinions also stress: "Accession of these countries is to be seen as part of a historic process, in which the countries of Central and Eastern Europe overcome the division of the continent which has lasted for more than 40 years, and join the area of peace, stability and prosperity created by the Union."[7]) However, EU membership also provides numerous economic advantages for both parties.

For first-wave countries, the recommendation means the acknowledgment of their efforts and also reflects the increasing international confidence in their economic development. Countries with whom negotiations have

been postponed for the time being have to face the fact that they are perceived as lagging behind the front runners in many ways. Although their efforts may have been acknowledged, this recognition was not as visible as in the case of the five other countries, which may bring about some disadvantages (for example foreign investors are likely to be more interested in opportunities in first-wave countries). Nevertheless, these countries could profit from the additional time this would give them to adjust their economies to European standards and to the competitive pressures within the Internal Market.

Not only the associated countries have to be prepared for enlargement, so does the European Union itself. Agenda 2000 is a general assessment of the accession request and gives recommendations for a strategy for the successful enlargement of the Union. At the same time, it presents an evaluation of the impact of enlargement on the Union's policies. We do not intend to present the entire reform package in this paper, nor will we go into the proposed necessary reforms of EU policies. We will focus instead on the Opinions on applicant countries[8]) and the proposed preaccession strategy.[9])

The main purpose of this paper is to provide a comparative analysis and an assessment of the economic aspects of the Opinions. Regardless of the outcome of the final decision of the European Council, these documents are of outstanding importance, because they will serve as a basis both for the EU accession negotiations and for the design of the respective preaccession strategies. Although we will give a broad overview of all ten Opinions, our in-depth analysis will focus on the five countries that the Commission recommended for the start of membership talks. While the Commission's choice may be debatable, we will refer to other applicant countries only in specific cases. In the comparison, we will limit ourselves to topics relevant to central banks (monetary and exchange rate policy, inflation performance, central bank independence, the banking sector, current and capital account convertibility and EMU relations) and consequently leave out of account other important aspects.

The paper consists of three parts. *First,* we will provide a comparative overview of the Opinions' statements about the abovementioned central-bank-related topics in the selected countries. *Second,* we will critically comment the Opinions and assess the recommendations made by the Commission. *Third,* we will briefly summarize and comment the Commission's proposed preaccession strategy. In this part, we will also sketch some future prospects, touching on the problems involved in integrating the other five applicants into the Union and on their prospects of joining at a later stage.

2 Comparative Analysis Based on the Opinions

In *June 1993 the European Council in Copenhagen* classified the obligations of membership for associated countries and ensured that the applicant countries could become full members of the Union as soon as they fulfilled these criteria and as soon as the Union itself was ready for enlargement. The political criteria require the stability of institutions that guarantee democracy, the rule of law, human rights and the respect for and protection of minorities. The economic criteria call for the existence of a functioning

market economy, and for the capacity to cope with competitive pressures and market forces within the Union. A third criterion for associated countries is the ability to take on the obligations of membership, including adherence to the aims of political, economic and monetary union.

The Opinions are based on comprehensive questionnaires filled in by the applicant countries[10]) and some supplementary information (bilateral meetings with national experts until May 1997) the Commission collected to get a complete picture of each topic. The avis[11]) have the official cutoff date May 31, 1997.[12])

The structure of each Opinion reflects the Copenhagen criteria in the Commission's interpretation and treats the applicant countries equally. In other words, the Opinions are all structured along the same lines and have approximately the same length for each of the ten countries.

In this section, we intend to provide a comparative overview of the applicants' preparedness for EU membership as presented by the Commission. We will begin by summarizing the Commission's interpretation of the Copenhagen criteria and stating which applicant countries fulfill the criteria in the Commission's view. In the more detailed comparison, we will then deal with topics relevant to central banks and focus on the five countries recommended for a start of accession negotiations. We will present our comments separately in a later section of this paper.[13])

2.1 General Remarks

Each country avis is basically structured as follows. After an introduction (Part A), the main part (Part B) describes the political (B.1), economic (B.2) and the *acquis* criteria (B.3) and their degree of fulfillment as well as the administrative capacity to apply the *acquis* (B.4). Part C, Summary and Conclusions, summarizes the assessment of each country and contains the politically most sensitive recommendations by the Commission to the European Council about the preparedness of the respective country to join the Union.

Part B is the most comprehensive part of each avis. Besides examining the fulfillment of membership criteria, it contains a lot of detailed information about a number of different political, legal, economic and social aspects.

Section B.1 *(political criteria)* describes the structure and functioning of the legislative, executive and judiciary powers, as well the applicant country's record on the respect of human rights and the protection of minorities. The Commission's assessment of the fulfillment of the political criterion is conducted on the basis of the present situation and does not outline any future prospects, which contrasts with the methodology applied for the examination of the other criteria.

According to the Commission, even though a number of applicant countries still have to make progress on actually practicing democracy and protecting minorities, only one of the ten applicant states, namely Slovakia, does not satisfy the political conditions laid down by the European Council in Copenhagen.

Section B.2 examines the implementation of the *economic criteria.* Under the Copenhagen definition, the economic criteria comprise two main

elements: the existence of a functioning market economy and the capacity to cope with the competitive pressures and market forces within the Internal Market. The Commission gives a picture of the present situation of the applicant economies and provides an analysis of expected progress over the medium term.

The Commission finds that five applicant countries can be regarded as *functioning market economies* (the Czech Republic, Estonia, Hungary, Poland and Slovenia). At present, Slovakia does not fulfill this criterion, but "has introduced most of the reforms necessary to establish a market economy." Latvia, Lithuania and Romania have made "considerable," while Bulgaria has made only "limited" progress in establishing a market economy.[14])

According to the Opinions, five applicants (the Czech Republic, Hungary, Poland, Slovenia and Slovakia) will have the *capacity to withstand the competitive pressures* and market forces within the Union in the medium term. Estonia "should be able to make the progress necessary" to become competitive in the Internal Market in the medium term. Latvia, Lithuania and Romania would "face serious difficulties" even in the medium term. In the case of Bulgaria, the Commission comes to the very critical conclusion that the country would not be able to cope with the competitive pressures and market forces.[15])

The Commission judges that within the group, the Czech Republic, Hungary, Poland and Slovenia will succeed in fulfilling the economic criteria in the medium term, while Estonia and Slovakia will come very close to this group.

Section B.3 *(acquis criteria),* which is the most comprehensive part of Part B, examines the capacity of each country to assume the obligations of membership, including the adherence to the aims of political, economic and monetary union, that is the capacity to implement the legal and institutional framework known as the *"acquis communautaire"* by means of which the Union puts into effect its objectives. The section describes the current and prospective situation of each applicant in each of the main areas of the Union's activities (for example the applicant's achievements in implementing the four freedoms, sectoral policies, justice and home affairs, environmental issues, EMU). The Commission depicts the present state of the countries' ability to implement the *acquis* and also provides an analysis of expected progress over the medium term. "In making this forward assessment, the Commission has taken into account programmes for progressively implementing the *acquis* under way … and the future development of the Union's policies, where the acquis is evolving rapidly."[16]) To illustrate the state of legislative adjustment in the applicant countries, the Commission presents a quantitative survey of the adoption and implementation of White Paper[17]) measures in different fields (see Table 1 below[18])).

The Commission concludes that the Czech Republic and Hungary will be able to comply with the *acquis* fully in the medium term if they continue their efforts on its transposition and make particular efforts in some fields. For Poland, the wording is slightly different; the Commission states that it "will be able to participate fully in the Single Market in the medium term."[19]) The Commission gave Estonia the most positive assessment in acknowledging

that it is the only applicant country to have already completed the transposition process.[20]) Slovenia, on the other hand, lags behind somewhat in the realization of the *acquis* criteria; the Opinion lists a considerable number of sectors requiring marked improvement.[21]) With substantial further effort, Latvia and Lithuania would also be able to fully participate in the Single Market in the medium term. Slovakia requires further progress to ensure the effective application of the *acquis.* Bulgaria and Romania have not adopted the essential elements of the *acquis* yet, so the Commission concludes that it is not likely that they will be able to apply the *acquis* fully in the medium term.

In December 1995 the European Council in Madrid concluded that an adjustment of administrative structures in the CEECs is necessary for a harmonious integration into the EU. Therefore section B.4 examines the administrative capacity to apply the *acquis,* that is the current state and prospective ability of the public administration, including parts of the judicial system, to carry out the functions required. The strengthening of administrative structures and further[22]) administrative reform will be "indispensable" for all applicants.

Table 1

Number of White Paper Measures
Implemented by the Associated Countries

White Paper measures for the Single Market	Directives		Regulations		Total
	Stage I	Stage II/III	Stage I	Stage II/III	
Number of White Paper measures	295	293	99	212	899
Bulgaria	78	27	19	2	126
Czech Republic	126	92	36	163	417
Estonia	87	58	22	116	283
Hungary	213	167	66	133	579
Latvia	139	80	26	8	253
Lithuania	164	119	24	9	316
Poland	197	154	52	2	405
Romania	197	154	52	2	405
Slovenia	165	102	30	118	415
Slovakia	263	253	86	62	664

Source: Information provided by the Opinions.
Notes: The table is based on information provided by the applicant countries' authorities, and the number of measures does not necessarily indicate the Commission's agreement. The table shows the number of measures for which the authorities have notified the Commission of the existence of adopted legislation that is to some degree compatible with the corresponding White Paper measures.

2.2 Monetary and Exchange Rate Policy

No specific chapter in the Opinions is exclusively devoted to monetary and exchange rate policies; these issues are briefly analyzed in three different subchapters of Part B of each Opinion. Monetary and exchange rate policy issues are touched upon in two subchapters of section B.2 (economic criteria), namely "Liberalization" and "Financial Sector." In addition, a paragraph can be found in section B.3 *(acquis* criteria) under the heading "Economic and Monetary Union."

The Opinions state that price stability can be regarded as the ultimate *goal of monetary policy* in the five recommended countries, although this objective is not clearly reflected in the respective central bank laws in the cases of Hungary, Poland and Slovenia.[23]) As to the chosen *intermediate targets,* most of the countries which target the exchange rate (except for Estonia)

have adopted another target as well: According to the Opinions, the Czech Republic sets a target range for money supply growth, and Poland moved from direct interest rate targeting to reserve money targeting in 1996. Interestingly enough, the Opinion on Hungary does not touch upon the choice of the intermediate target of monetary policy. Slovenia, which operates a managed floating exchange rate regime, officially targets money supply.

According to the Commission, monetary policy in the five recommended countries has been successful in establishing a stable macroeconomic environment and reducing inflation in the past years. This generally positive assessment is qualified somewhat for Hungary, where monetary policy "implemented since March 1995" is seen as successful and for Poland, whose monetary policy the Commission views "broadly speaking" as successful.[24])

With the exception of Estonia, which operates a currency board system, all recommended countries use *indirect instruments* to control money supply, such as open market operations, discount and lombard rates, and minimum reserve requirements. A special problem in Slovenia mentioned in the avis is the lack of government papers that results from the country's sound fiscal record (it has no budget deficit), which makes it difficult for the central bank to use open market operations to control money supply. Remarkably, the use of indirect instruments is not mentioned in the avis on Poland. Slovakia only recently switched to the full use of indirect instruments, since the remaining credit ceilings on individual banks were abolished only in January 1996.

Hungary got the best marks, as it were, compared to the other recommended countries for the *effectiveness of monetary policy.*[25]) Bank privatization is far advanced, the amount of bad loans has been markedly reduced, and the market for government papers is one of the most developed in the region. The Commission identifies a number of factors that still prevent monetary policy from being efficient in the Czech Republic. In Poland and Slovenia, however, the uncompetitive, state-dominated banking sectors are still waiting to be privatized and are typically burdened with a large amount of bad loans on their balance sheets. In Slovenia, widespread indexation, most importantly of interest rates and wages, is identified as the major problem preventing the efficiency of monetary policy.[26])

For each applicant country, the Commission briefly describes the chosen exchange rate regime and identifies a broad variety of different regimes across the ten applicant countries, ranging from the extreme model of a currency board with a fixed peg to rather flexible systems (see Table 2 below). Because the Opinions' cutoff date was May 31, 1997, the Opinion on Bulgaria could not yet fully take into account the country's switch to a fixed peg vis-à-vis the Deutsche mark and the introduction of a currency board arrangement at the beginning of July 1997.

The crawling peg regimes in Hungary and Poland and the fixed peg of the Estonian kroon are deemed very successful in curbing inflation.[27]) Although the currency crisis in the Czech Republic, which was very recent at the time, is analyzed in detail, the analysis does not substantially worsen the assessment of Czech exchange rate policy. No explicit assessment of the exchange rate regime can be found in the Opinions on Slovenia and Slovakia. The central

banks of Latvia and Lithuania are praised for successfully maintaining the credibility of their exchange rate pegs despite the banking crises that both countries faced in 1995. While the Commission does not explicitly criticize the exchange rate policies pursued by Romania and Bulgaria (before the latter introduced a currency board), it does describe the difficulties the central banks experienced when they tried to intervene in the foreign exchange markets.[28])

Table 2

Exchange Rate Regimes in the Applicant Countries according to the Opinions

	Exchange rate regimes adopted		Exchange rate regimes adopted
Bulgaria	free float	Poland	crawling peg
Czech Republic	managed float	Estonia	peg to the Deutsche mark
Romania	managed float	Latvia	peg to the SDR
Slovenia	managed float	Lithuania	peg to the U.S. dollar
Hungary	crawling peg	Slovakia	peg to a basket

Source: Information provided by the Opinions.

A major monetary and exchange rate policy problem identified by the Commission is the massive *inflow of speculative capital,* mostly in the form of portfolio investments, that was observed in the last years and that endangered the ability of the central banks to control monetary aggregates. The Czech Republic (1994/95), Poland (since mid-1994) and Slovenia (mid-1992 to mid-1994) were particularly affected by these developments. It is interesting to note that the policy responses of these countries were quite different: The Czech Republic and Poland widened the fluctuation bands of their exchange rates in February 1996 and May 1995, respectively, to add a larger element of risk to currency speculation. Furthermore, in December 1995 the Polish central bank revalued the zloty by 6% in nominal terms. Slovenia, on the other hand, gradually imposed restrictions on capital movements to stem capital inflows. The Commission quite legitimately criticizes this policy as being incompatible with the EU Association Agreement. Interestingly, the Opinion on Hungary does not tackle the problem of speculative capital inflows at all.

2.3 Inflation Performance

After the initial surge in prices following price liberalization and the adjustment of prices to world market levels in the ten countries, inflation showed a declining trend almost across the board. However, considering the data provided in the Opinions, the countries will reach the European average only in the medium or even in the long term.

Table 3 shows the inflation performance of the ten applicant countries in the last three years. Slovakia has the best record among the applicants and posts the lowest inflation rate. By the end of 1996 the Czech Republic and Slovenia had managed to reduce their inflation rates to single digits, while CPI inflation in Estonia, Hungary and Poland was around 20%. In Bulgaria and Romania, which did not succeed in attaining a sufficient degree of price stability, the governments introduced radical macroeconomic stabilization

Table 3

The Inflation Performance of the Applicant Countries

	Inflation rate 1994	1995	1996
	annual average, percent		
Bulgaria	96.0	62.0	123.0
Czech Republic	10.0	9.1	8.8
Estonia	47.7	29.0	23.1
Hungary	18.8	28.2	23.6
Latvia	35.9	25	17.6
Lithuania	72.2	39.6	24.6
Poland	32.2	27.8	19.9
Romania	136.7	32.3	38.8
Slovenia	19.8	12.6	9.7
Slovakia	13.3	9.9	5.8

Source: Information provided by the Opinions.

and structural reform programs (primarily tight monetary and fiscal policies) in 1997.

Except in Hungary, where "almost all transactions take place at market prices,"[29]) the downtrend of inflation in the recommended countries could be endangered by the significant share of goods and services with administrative prices in the basket on whose basis the consumer price index is calculated. In the Czech Republic further price liberalization and deregulation could boost inflation in the near future, so that "some very firm action is needed to contain the existing pressures."[30]) In Estonia 25%, in Poland 23% and in Slovenia 26% of the goods and services in the basket are still under administrative control.[31]) The Commission does not explicitly mention any dangers in the case of Hungary. However, while it stresses the fact that inflation and interest rates follow a relatively stable and predictable downward path in Hungary, it also states that a more rapid reduction of inflation appears to be difficult.

2.4 Central Bank Independence

Each Opinion briefly treats the issue of central bank independence in two different sections in Part B, namely Chapter B.2.1, Financial Sector, and Chapter B.3.3, Economic and Monetary Union.

In the Commission's view, all central banks of the recommended countries with the exception of Poland enjoy a relatively high degree of *independence from government bodies in the conduct of monetary policy.* In the Opinion on Poland, the Commission states that the central bank is "not explicitly provided with formal independence from the government in the conduct of monetary policy." This legitimate criticism refers to the Polish central bank legislation in force until July 1997.[32]) However, on May 27, 1997, Poland adopted a new Constitution by referendum. This Constitution enshrined the independent status of the central bank and entailed fundamental changes in central bank legislation. Accordingly, the law on the National Bank of Poland was amended in July 1997 and endowed the central bank with the sole right to determine and implement monetary policy.

The Opinions very briefly touch upon *appointment procedures of central bank governors,* and conclude that in four of the five recommended countries, the central banks enjoy a high degree of personal independence.[33]) Inter-

estingly enough, criticism is voiced on Hungary's handling of appointments, because according to the Commission, "appointments of new governors have coincided with changes in the government in practice."[34])

The Commission correctly identifies the weakest point in the applicant countries' central bank legislation, namely the provisions about *budget deficit financing by the central bank.* According to the Opinions, the central bank laws of the Czech Republic, Hungary, Poland[35]) and Slovenia are still not in line with the Maastricht Treaty, which requires an explicit prohibition of central bank credit to the government.[36]) Although the Opinions do not expressly say so, a fact well worth noting is that the central bank laws of the four abovementioned countries typically set a maximum amount[37]) for short-term liquidity loans to the government, but stop short of an outright prohibition of direct budget financing. The only exception is Estonia, whose central bank contains such a prohibition.

2.5 Banking Sector

The financial sector, especially the banking sector, plays an important financial intermediation role by channeling savings towards productive investment. The Opinions also stress the importance of a well-developed financial sector in judging the existence of a functioning market economy and the ability to fulfill the obligations of Economic and Monetary Union. Therefore, the Commission examines financial sector developments critically and in great detail.

It is very difficult to obtain a complete impression of the Commission's assessment of the banking sector, as eleven different subchapters of each Opinion refer to this topic.[38]) In analyzing the state of the banking sector, the Commission examines the following indicators: the degree of restructuring and state participation, the share of foreign ownership, the level of concentration, the fulfillment of the financial intermediation role and the ability to compete. The Commission sees the adoption of the legal framework as a necessary condition to create a stable financial environment in these countries, but distinguishes between adopted and implemented banking directives: The proper everyday functioning of the directives is essential for a country to compete in the Internal Market.

All applicant countries have introduced a two-tier banking system to clearly distinguish between central bank functions and commercial bank operations, although the Opinions on Latvia and Slovakia do not explicitly mention this fact. Banks still face the serious problems of undercapitalization, bad loans and a lack of competitiveness in most of the countries. Almost all of the countries introduced new banking laws in 1996 or 1997. However, in many instances they are far from fully compatible with the *acquis,* and their practical implementation and functioning requires monitoring even in countries with advanced legislation of an EU standard.

Table 4 shows the level of integration of White Paper measures on financial services into national legislation. We can see that Hungary, Lithuania, Poland, Romania and Slovakia are in a somewhat more favorable position than the others, but none of the countries has fully implemented all (high priority) Stage I measures yet. Table 5 gives an overview of the level of

Table 4

Number of White Paper Measures on Financial Services Implemented

White Paper measures on financial services	Directives		Regulations		Total
	Stage I	Stage II/III	Stage I	Stage II/III	
Number of White Paper measures	13	8	0	0	21
Bulgaria	6	3	0	0	9
Czech Republic	8	3	0	0	11
Estonia	8	6	0	0	14
Hungary	12	8	0	0	20
Latvia	9	5	0	0	14
Lithuania	11	6	0	0	17
Poland	10	7	0	0	17
Romania	10	7	0	0	17
Slovenia	7	0	0	0	7
Slovakia	12	6	0	0	18

Source: Information provided by the Opinions.

implementation of specific banking directives in individual countries. None of the applicants has implemented the Stage II Capital Adequacy Directive yet; consequently capital adequacy regulations are still based on credit risk alone in these countries (hence market risks are not handled).

The *level of competitiveness* in the banking sector differs among the five recommended countries. According to the Commission, the banking sector is sound and expanding in Estonia and Hungary, needs further reforms in Poland and, for several reasons, is not sufficiently competitive or strong in the Czech Republic and Slovenia. The Commission also stresses that competition is greatest in the Estonian banking sector, where branches of foreign banks can be opened and operated under the same conditions that apply to domestic banks.

According to the Commission, the *concentration* in the banking sectors of the applicant countries is very high. Nearly all of the banking sectors are

Table 5

The Implementation of the European Community's Banking Directives

Banking Directives	Czech Republic	Estonia	Hungary	Poland	Slovenia[1])
Stage I measures					
First Banking Directive	+	+	+	+	n.m.
Own Funds Directive	n.m.	+	+	+	n.m.
Solvency Directive	+	+	+	+	n.m.
Money Laundering Directive	–	–	+	+	n.m.
Deposit guarantee schemes	–	–	+	+	n.m.
Stage II measures					
Second Banking Directive	+	+	n.m.	n.m.	n.m.
Capital Adequacy Directive	–	–	–	–	–
Large Exposure Directive	+	+	+	+	n.m.
Accountancy Directives	n.m.	+	+	+	n.m.
Consolidated supervision	–	–	n.m.	–	n.m.

Source: Based on information provided by the Opinions.
Notes: "n.m." = not mentioned, "+" = implemented or partially implemented, "–" = differences between country and Community legislation exist.
[1]) The Opinion on Slovenia only says that the laws and regulations in the banking sector are similar to those of the EU, namely to the Stage I measures, and are being further harmonized with European directives under the new legislation to be adopted by the end of 1997.

dominated by a few large banks. In the Czech Republic, 80% of the banking business is concentrated in four main banks. The sector is also fairly concentrated in Estonia according to the Opinion; however, the avis contains no precise figures. The five largest banks accounted for just under 60% and 50%, respectively, of total banking assets in 1996 in Hungary and Poland. The three biggest Slovenian banks cover more than half of the market in terms of balance sheet totals.

State participation in these countries is higher than the European average, mainly for historical reasons and because of the incomplete privatization process. In the Czech Republic, the four major banks have not been privatized yet, and seven additional banks are partly owned by the state. The role of the state has been greatly reduced in the Estonian banking sector: At present, the state owns stakes in only two credit institutions; moreover, the government intends to sell these shares as well in the coming years. The bank privatization process is almost complete in Hungary, and resulted in a comparatively large share of foreign ownership, but the Commission stresses the need for steady continued privatization.[39]) At the end of 1996 the state held just below 50% of the total share capital of commercial banks in Poland, which means that the banking sector is still largely state-owned.

Bad loans remain a problem in the Czech Republic, Estonia, Poland and Slovenia. Bad loans were reduced to noncritical levels in Hungary following the adoption of repeated bank consolidation schemes.

The central bank is responsible for *banking supervision* in the Czech Republic, Estonia and Slovenia. In Hungary and Poland the supervisory authorities for banks[40]) are independent from the respective central bank.

It is also important to point out that the Czech Republic and Slovenia have some significant *country-specific difficulties.* The adopted privatization scheme has resulted in crossownership among Czech banks and investment funds, which hold shares in the enterprises to which banks lend. This leads to conflicts of interest in corporate governance, as banks are both owners and creditors. Slovenia has a relatively concentrated banking sector, but is nevertheless overbanked: According to the Opinion on Slovenia, many of the banks are too small, and the number of banks is too high considering the size and the economic needs of the country. The Slovene banking sector is burdened with another difficulty in meeting EU requirements, namely that banks have concluded an interest rate arrangement with the approval of the Bank of Slovenia and the Anti-Monopoly Office whereby the cartel sets an upper limit on commercial banks' deposit rates.

2.6 Current Account Convertibility

Applicants have taken on convertibility obligations – including current account convertibility – vis-à-vis the EU in the Association Agreements. All countries except Bulgaria and Romania have applied the obligations of Article VIII of the IMF's Articles of Agreement and have consequently introduced full current account convertibility. Some countries have liberalized even more, such as Estonia, where no exchange restrictions whatsoever apply to capital transfers to and from the country, and Latvia, where only few restrictions remain.

Table 6

Current Account Convertibility in the Applicant Countries

	IMF Article VIII obligations		IMF Article VIII obligations
Lithuania	May 3, 1994[1])	Slovakia	October 1, 1995
Estonia	August 15, 1994	Slovenia	September 1, 1995[1])
Latvia	June 10, 1994	Hungary	January 1, 1996
Poland	June 1, 1995[1])	Bulgaria	–
Czech Republic	October 1, 1995	Romania	–

Source: Information provided by the Opinions.
1) The respective Opinions do not indicate the exact date of the declaration.

The Bulgarian lev and the Romanian leu are convertible for most current account transactions, and, according to the Opinion on Romania, the Romanian authorities expect to be able to assume Article VIII obligations in the course of 1997.[41])

2.7 Liberalization of Capital Movements

The issue of capital account liberalization is presented in section B.3.1 (The Four Freedoms, Free Movement of Capital). In each of the Opinions, the Commission refers to the White Paper, which suggests "a sequence of capital liberalization, starting from long-term capital movements and those linked to commercial operations and subsequently focusing on short-term capital."

According to the Opinions, Estonia has introduced a far greater degree of liberalization of capital movements than the other applicants have; it already exceeds the obligations undertaken under the Europe Agreement. The Commission does not identify "any major obstacles for accession in the medium term" in the field of capital account liberalization.[42])

The Opinions draw a distinction between the Czech Republic, Hungary and Poland, although all of these countries have made progress with fairly substantial capital movement liberalization in the context of their accession to the OECD.[43]) In the view of the Commission, the liberalization of capital movements has been most substantive in the Czech Republic, and the Commission expects the country "to be able to eliminate, without major difficulties, the remaining restrictions on the movement of capital in the medium term and assume fully the Community acquis in this area." The Commission regards Hungary's and Poland's progress on capital account convertibility as "considerable," but "further efforts are still required" in specific areas in Hungary and across a broader range of items in Poland. This differentiation is largely echoed in Part C, Summary and Conclusions, of the three avis: Full capital account convertibility is not seen to constitute problems for the Czech Republic and appears to be within reach for Hungary, while in the case of Poland, the Commission concludes that "work is still needed" on the liberalization of capital movements.

The Commission is rather critical about the capital account regulations in Slovenia: The liberalization of capital flows has made slow progress and "under the current framework of monetary and exchange policies, there is little prospect of an important move towards further capital liberalisation." Consequently, in Part C, Summary and Conclusions, the Commission

chooses an even more critical wording than in the case of Poland and states that "substantial work is still needed ... in the field of capital movements."

2.8 Economic and Monetary Union Relations

According to the Copenhagen criteria, applicant countries have to adhere, inter alia, to the aims of Economic and Monetary Union. Consequently, fulfilling the Maastricht criteria is not a condition for joining the European Union. Still, the convergence criteria "remain key points of reference for stability oriented macroeconomics policies, and must in time [but not necessarily upon accession] be fulfilled by new member states on a permanent basis."[44]) Each country Opinion contains the statement that "it is premature to judge whether [the respective applicant country] will be in a position, by the time of its accession, to participate in the Euro area; that will depend on the success of its structural transformation permitting to attain and to adhere permanently to the convergence criteria."[45])

The focus of the Commission's observations is on the two main obligations applicant countries will have to meet in order to participate in Stage Three of EMU as non-euro area countries: the adoption of the *acquis communautaire* of Stage Two of EMU and close and institutionalized monetary and exchange rate policy cooperation with the European Union.

The *acquis dimension of EMU* relates to the Treaty provisions on the coordination of economic policies (including adherence to the regulations of the Stability and Growth Pact that are binding for all EU Member States), central bank independence, price stability as the prime objective of central bank policy, the prohibition of direct central bank financing of budget deficits, the interdiction of privileged access of public authorities to financial institutions and, last but not least, the liberalization of capital movements.[46])

Monetary and exchange rate policy cooperation with the European Union has two main aspects. First, the newly acceeding countries will participate in the European System of Central Banks, though on a restricted basis.[47]) Second, upon joining the Union they are expected to participate in an exchange rate mechanism.[48])

The Commission concludes that participation in Stage Three of EMU as a pre-in country should pose "no problems" in the medium term for the Czech Republic, Hungary and Poland and "few problems" for Estonia. With this conclusion, the Commission implies that existing weaknesses can be overcome (in the case of Estonia "largely overcome") by the time the countries join the European Union. Typically, the criticism relates to the yet uncompleted harmonization of central bank legislation and to financial sector deficiencies.[49])

On Slovenia, the Commission arrives at the following assessment: In the detailed EMU-related review, it finds that the country's "participation in the third stage of EMU as a non-participant in the euro area should pose no problems in the medium term." Hence, based on this section, Slovenia is expected to eliminate in due time the weak spots identified by the Commission. As in the other four countries, these pertain to central bank legislation and financial sector restructuring, furthermore to monetary

policies "able to curb speculative capital inflows without resorting systematically to capital controls." Part C, Summary and Conclusions, of the Opinion states that Slovenia's participation in the third stage of economic and monetary union with a pre-in status "could present some difficulties." This implies that, in the final analysis, the Commission is not fully confident that Slovenia can overcome EMU-related weaknesses until EU accession.[50])

3 Critical Assessment of the Opinions

In this section, we will analyze and comment the Commission's Opinions. We will begin with some remarks about the general conception of the Opinions, their internal consistency and the horizontal consistency with respect to other documents of the Agenda 2000 package. Second, we will comment on the Commission's interpretation of the Copenhagen criteria and its implications for the country assessments. Third, we will discuss the Commission's approach to select five out of ten applicants and will shed some light on the possible consequences of this selection in particular for nonrecommended candidate countries. Fourth, we will analyze in detail those parts of the Opinions which touch upon issues of relevance for central banks, namely monetary and exchange rate policies, inflation performance, central bank independence, the banking sector, capital account liberalization and EMU relations.

3.1 General Remarks

As pointed out earlier, the structure of each Opinion is basically a reflection of the Copenhagen criteria as laid down in June 1993. In checking the degree of fulfillment of these criteria for each of the applicant countries, the Commission has produced a comprehensive and, by and large, a very detailed analysis that covers the different aspects of each criterion. As this kind of exercise requires very specific expertise in a variety of different areas, the Opinions are obviously put together from contributions provided by different Directorates General of the Commission. While the Commission has certainly done a commendable job in providing ten in-depth country analyses in a very limited span of time, overlappings or double coverage of some topics could not be avoided fully. Moreover, a very important source of information for each Opinion was provided directly by the applicant countries (replies to detailed questionnaires, bilateral consultations with national experts), which was certainly even more difficult to check thoroughly simply for time and capacity reasons. Whereas some interlinkages between the different subchapters of each Opinion can be found, the Opinions generally create the impression of being a "patchwork" of different contributions rather than one integrative document.

One result of this rather piecemeal approach is that the wording of some subchapters presented in Part B of each country Opinion is not fully consistent with Part C, Summary and Conclusions, of the same Opinion. A case in point is the Commission's assessment of price liberalization in Estonia.[51]) Moreover, sometimes the views expressed in a particular subchapter are not consistent with the wording of other subchapters of the same Opinion. As an example, we would like to point out the Commission's

assessment of the progress in privatization achieved by the Czech Republic.[52]) Furthermore, in some cases inconsistencies can be found even between the individual country Opinions and other documents of the Agenda 2000 package. This applies, e.g., to the differing statements on the fulfillment of the economic criteria by the applicant countries.[53])

3.2 The Application of the Accession Criteria

The accession criteria, as defined at the Copenhagen Summit, were formulated in a rather general way and needed to be made more explicit and operational. The White Paper was published to help fulfill this task. It gave concrete guidelines to applicants, though only in the area of the Internal Market *acquis.* The political and economic criteria were not interpreted in detail until the publication of the Agenda 2000 package.

Interestingly, the *political criteria* are assessed on the basis of the present situation in each applicant country, whereas the economic and *acquis* criteria are evaluated on a forward-looking basis. According to the Commission, this approach was chosen because "an assessment [of the political situation] could be conducted only on the basis of elements of the present situation which [the Commission] has been able to verify and confirm."[54]) While this consideration is certainly justified, the Commission's assessment of the political situation can only provide a snapshot of the situation in June 1997 and therefore has to be interpreted with caution. At the same time, the Commission stresses that the fulfillment of the political criteria is regarded as a primordial condition for membership. If we consider that the applicants have fledgling multiparty political systems, that they look back at a very short history of democracy and that a stable political environment and stable institutions are still in the process of being established, the fulfillment of the political criteria will have to be observed and regularly updated with great care also after the publication of the Opinions.

In 1996, the Commission's experts started to discuss intensely how the *economic criteria* should be interpreted and operationalized. The paper by Ilzkovitz and Daviddi[55]) constituted one of the important steps in this process and served as the basis for the methodology the Commission presented in Agenda 2000. According to the Commission's interpretation, the term *"existence of a functioning market economy"* comprises a number of different sub-conditions ranging from macroeconomic aspects[56]) to systemic requirements[57]) and also to political conditions[58]). The second part of the economic criteria, as defined in Copenhagen, refers to the *"capacity to withstand competitive pressure and market forces within the Union."* The Commission's detailed interpretation of this condition contains a number of micro-economic requirements[59]) as well as requirements on the economic policies pursued by the applicants.[60]) It is interesting to note that the very first subcondition the Commission lists as being necessary to withstand competitive pressures is the existence of a functioning market economy. Logically, this would imply that the second part of the economic criteria ("capacity to withstand competitive pressures") can be fulfilled only if the first part ("functioning market economy") is in place. Nevertheless, in the Opinion on Slovakia, the Commission concludes that the country will have

the capacity to stand up to competitive pressures in the medium term, although at the same time it identifies a number of problems Slovakia will come up against on its way to becoming a functioning market economy.[61])

As mentioned, apart from the analysis of the present situation, the Commission has embarked on the enormous task of providing a forward-looking assessment of the *acquis* criterion. This appears to be extremely difficult: The applicant countries are compelled to approach a "moving target," because the Union's *acquis* itself develops very fast. Moreover, the *acquis* criterion also includes the "adherence to the aims of *political,* economic and monetary union" and thus comprises the very sensitive area of common policies. A prospective assessment of the fulfillment of the *acquis* criteria in the medium term, as provided by the Commission, therefore implicitly contains a judgment on the future political developments in the candidate countries, so that fulfillment cannot be assessed independently of the political situation.

Another very important question refers to *the respective weights of the individual criteria* applied by the Commission when producing an overall assessment of each country. While the Commission clearly states that the fulfillment of the political criteria is regarded as an indispensable prerequisite for starting negotiations, the weights of the different areas of the economic and *acquis* criteria do not appear quite clear to the reader. It seems to us that the Commission has given different weights to the conditions in the case of different countries. This is true, for example, of the Commission's assessment of Slovenia's readiness to join Economic and Monetary Union in the medium term, which is more critical than that of the other recommended countries: In the Opinion on Slovenia, deficiencies in central bank legislation are explicitly mentioned in Part C, Summary and Conclusions, although the deficiencies identified in the main text of the avis do not differ from those identified for the Czech, Polish and Hungarian legislation.[62])

3.3 The Country Recommendations

By recommending five applicants out of the ten to begin membership talks with, the Commission made a clear statement about which countries it considers to be most advanced in terms of political and economic transition and therefore most prepared for EU membership. Although Commission representatives have stressed several times that such a differentiation between the candidates should not be understood as discrimination, the publication of the Opinions in July 1997 sent a clear signal not only to the applicant countries, but inevitably also to the international community, and it triggered world-wide reactions.

The Commission's country recommendations undoubtedly have *political consequences.* The selection of only five out of ten candidates could create new, artificial boundaries between EU aspirants in Central and Eastern Europe, a fear which has been voiced repeatedly by the nonrecommended countries. In addition, new boundaries could be drawn between the ten associated countries and other Central and Eastern European transition economies that might also strive for EU membership at a later stage.

While it may be economically justified, the distinction between Estonia and the other two Baltic States, for example, appears to be rather problematic from the political point of view. This is not only due to the historic and geographic proximity of these countries, but also to the already high degree of economic integration between the Baltic States.[63]) Consequently, the Latvian and Lithuanian authorities expressed their disappointment. Prime Minister Skele of Latvia stressed that the Commission's decision to invite only Estonia to the accession negotiations was "due to the incompetence of Brussels and undermines Baltic unity."[64]) Nor did the Lithuanian government agree with the Commission's assessment; it underlined that for several reasons Lithuania was not "lagging behind leading EU membership candidates from Central and Eastern Europe."[65])

Other nonrecommended countries have also voiced their disappointment. The Romanian government expressed general criticism about the distinction made by the Commission among candidate countries, and Prime Minister Ciorbea emphasized the inconsistency of the Commission's viewpoint "with the principle of equal chances for EU associate countries" as declared in Copenhagen.[66]) Bulgaria, however, generally accepted the Commission's judgment.

In the case of Slovakia – the only candidate not recommended for primarily political reasons – the Commission's assessment may contribute to the necessary international pressure on Slovakia to improve its democratic system. On the other hand, the Commission's recommendation could be perceived as an exclusion from the accession process, which in Slovakia could negatively influence public opinion on EU integration.

However, the Commission's recommendations cannot be seen as having purely political effects; their consequences inevitably have an *economic dimension* as well. The opening of accession negotiations with only a selected group of candidates might have effects on the international financial markets, deterring potential foreign investors from investing in certain countries. Moreover, in our view it cannot be excluded that even the credit ratings for some countries, and for some companies, are downgraded. This would affect the competitiveness of these countries or companies by increasing financing costs. Furthermore, the accession of only a selected group of countries might decrease the degree of economic integration among applicant countries (e.g. in the form of CEFTA[67])), which only started to develop after the collapse of the CMEA. Moreover, when former CEFTA members become EU members, their economic relations with the remaining CEFTA countries will be determined solely by the Association Agreements, which – in some areas of trade liberalization (e.g. agriculture) – are not as far-reaching as the already existing CEFTA agreement. This could imply the reintroduction of trade restrictions in some areas.

In view of the political and economic impact of the Commission's recommendation, the final decision to be taken by the European Council has to be prepared with great care, because it might have an impact on the whole of Europe. Therefore, it comes as no surprise that EU Member States are currently discussing alternative approaches to the Union's Eastern enlargement. The broadest approach, which is supported inter alia by the European

Parliament,[68]) suggests extending a *simultaneous invitation* to all ten applicant countries (with the exception of Slovakia) to open accession negotiations. Although this approach would cause the least political difficulties in the Union's relations with the candidates, parallel negotiations with nine (in fact together with Cyprus ten) countries would probably exceed the personnel and administrative capacity of the Union and could thus slow down the approximation process for the most advanced countries. An alternative model recently suggested by German Foreign Minister Kinkel[69]) uses the metaphor of a "stadium" in which each candidate ("athlete") can take part in the "open race" for EU membership. We interpret this metaphor to mean that even "latecomers" (i.e. presently not recommended countries) potentially have the chance to join the race, pass others and even "cross the finish line" (i.e. join the EU) ahead of those in the lead today (i.e. the recommended countries). The implementation of such a "stadium model" in practice will crucially depend on the exact definition of the preaccession strategy.

3.4 Critical Assessment of Issues Relevant to Central Banks

In this section, we will analyze how central-bank-relevant issues are dealt with in the country Opinions, focusing on the following areas: monetary and exchange rate policy, inflation performance, central bank independence, the banking sector, the liberalization of capital movements, and EMU relations.

It has to be stressed that the most sensitive issues in membership talks will probably be agricultural policies, the free movement of persons and hence the opening of the labor market, as well as future regional transfers for new members (Structural Funds). Therefore, the Commission had to reserve ample room for these topics in each Opinion and touched rather briefly on the abovementioned central banking issues, as the applicants are generally more advanced here, so that these issues will probably not cause major problems during the accession negotiations.

3.4.1 Monetary and Exchange Rate Policy

As pointed out earlier, the area of monetary and exchange rate policy is treated in several subchapters of each Opinion, which inevitably leads to double coverage of some areas[70]) and some inconsistencies in the Commission's assessment of policies.

The Commission's analysis of the applicants' monetary policy goals, intermediate targets and instruments is performed accurately and gives a clear picture of the applicants' preparedness for membership in this area. While we agree with the Commission's assessment that *monetary policy* has generally been *successful* in reducing inflation in the Czech Republic, Slovenia and Estonia, the very positive wording in the case of Hungary ("undoubtedly successful") and Poland ("broadly speaking successful") does not seem fully consistent with the assessment of other candidate countries. Although the inflation performance – both in absolute terms as well as in terms of inflation reduction – of Hungary and Poland does not measure up to the achievements of other countries, even nonrecommended ones such as Latvia, Lithuania or Slovakia, the wording of the respective chapters on monetary policy in the individual country Opinions does not reflect this. Whereas Latvia's and

Slovakia's monetary policies are given an at least positive assessment similar to that of the recommended countries,[71]) the Opinion on Lithuania does not even mention monetary policy achievements.

As pointed out earlier, each of the Opinions contains a brief description of the *chosen exchange rate regime,* which is correctly elaborated for most countries. However, it is interesting to note that the Slovene exchange rate regime is depicted by the Commission as "shadowing the Deutsche Mark."[72]) In our view, the Slovene exchange rate policy stance in the past years deserves a more detailed analysis: While the nominal exchange rate of the Slovene tolar recorded a substantial depreciation vis-à-vis the Deutsche mark between 1991 and 1993, this tendency slowed down in the course of 1994, when the Bank of Slovenia started to keep the nominal exchange rate of the tolar stable against the Deutsche mark. This policy was maintained until mid-1995, when the tolar started to nominally depreciate again until the beginning of 1996. Since then, the tolar has been virtually stable vis-à-vis the Deutsche mark.[73]) Furthermore, we do not fully agree with the Commission's qualification of Latvia's exchange rate regime as a "peg to the IMF Special Drawing Rights (SDR)."[74]) To our knowledge, Latvia has only informally adopted a peg to the SDR; formally it operates a managed float.[75])

As mentioned earlier, the Opinions assess the exchange rate regimes adopted by most applicant countries as rather positive. However, although the Czech currency crisis is analyzed in detail and the growing current account deficit is identified as one of its main reasons,[76]) no considerations about the sustainability of the exchange rate peg can be found in the Opinions on Estonia or on Slovakia. Although in both cases the Commission correctly identifies the worsening current account deficits as serious risks for macroeconomic imbalances in the respective chapters on macroeconomic developments,[77]) no reference is made to this issue in the assessment of the prospects of their adopted exchange rate regimes.

It is remarkable that the Opinions do not touch upon or question the composition of the *currency baskets* in Hungary, Latvia, Poland and Slovakia.[78]) In view of the introduction of the euro in the near future and of the high degree of trade integration of these countries with the EU, the Commission could have suggested a critical revision of these currency baskets. In our view, the weight of the dollar, which is still very strong in these baskets, could be reduced further in favor of a European currency.

3.4.2 Inflation Performance

The Commission presents a description of the inflation performance of the applicants and focuses on trends until the present. As the sources of inflation are not fully examined, the Commission's assessment of the sustainability of the achievements in the medium term remains somewhat unclear: Some possible risks to a further reduction of inflation are mentioned (e.g. the role of administrative prices), but no prospective analysis is given of what happens if these risks are not properly handled. In any event, the Opinions do not analyze the issue of inflation inertia, especially that in Hungary and Poland.[79]) Thus the Commission does not fully consistently uphold its underlying principle of examining the economic criteria not only

on basis of the present situation, but also on the expected progress in the medium term.

According to the Commission, sustainable price stability is a condition for macroeconomic stability and hence also a condition for the fulfillment of the economic criteria. Therefore, the identification of the basic trends and proper acknowledgment of efforts made by applicants is essential. However, the figures given in the tables sometimes contradict the main text of the Opinions. For example, the Opinion on Poland states that "the 1995 inflation outcome was quite disappointing, with the inflation rate at about the *same level* as it was in 1994"[80]), namely 29.4% in 1994 and 21.9% in 1995; see also Table 2 of this paper. Another case in point is the Czech Republic, where the Commission criticizes that the average yearly "inflation of 1995 was *stuck at* the previous year's level" [81]), namely 10.0% in 1994 and 9.1% in 1995; see Table 2 of this paper.

The Latvian and Lithuanian authorities[82]) claimed that the Commission did not take into consideration the most recent data (first months of 1997); it would have provided a much more positive picture of the inflation performance in their countries. However, the Commission cannot be blamed for an unequal treatment of candidates because none of the Opinions analyzes 1997 inflation figures.

3.4.3 Central Bank Independence

Each of the ten Opinions very briefly touches upon the issue of central bank independence. Typically, the Opinions mention the *statutory objectives,* the independent status of the bank from the government in the formulation of monetary policy and the *appointment procedures* for the central bank governor. We agree with the Commission that the central bank legislation of the applicant countries is broadly in line with the requirements of the Maastricht Treaty in the abovementioned areas. As pointed out earlier, the Commission correctly states that the weakest point in the existing central bank legislation concerns the *regulations on direct central bank lending* to the government, which in principle is still permitted, though largely constrained, in most candidate countries.[83])

However, while we share the Commission's criticism on the *appointment practices* of central bank governors in Hungary, where in the Commission's view appointments have "coincided with changes in the government," we do not fully understand why this deficiency is not also mentioned for Poland, where an even higher turnover rate of central bank governors has been observed in recent years.[84])

The issue of central bank *accountability* to parliament, which is required by the Maastricht Treaty, is explicitly mentioned only in the Opinions on the Czech Republic and Estonia, although comparable legislation is in place in Hungary, Poland, Slovakia and Slovenia.

Moreover, the following very *important aspects* of central bank independence have been *completely disregarded* in the Opinions' analysis – most probably because this topic is accorded only a limited space in each avis: the legislated term of office of central bank governors, their possible dismissal, the appointment and dismissal of other members of the highest

decision-making body, incompatibility clauses for central bank officials and the budgetary independence of the central bank.

3.4.4 Banking Sector

As mentioned earlier, the adoption of the *acquis* in the area of banking legislation is seen as a necessary condition to create a stable financial environment in the applicant countries. Consequently, the Commission examines the degree of harmonization of the national banking laws with the European legislation for each candidate country. One important yardstick for a country's preparedness in this area is the number of *White Paper measures* already implemented. However, we do not fully understand the Commission's generally positive assessment of Estonia's banking sector in the Opinion, which is seen as "sound and expanding,"[85]) although the implementation of White Paper measures on financial services is clearly behind that of five other applicants (see Table 4 of this paper). In our view, it is difficult to judge the soundness of a banking sector which is not yet subject to a legislation harmonized with European standards, because many of the performance indicators typically used are not defined in a comparable way. Moreover, the Commission examines the implementation of the *European banking directives* (see Table 5 of this paper). Although the Opinion on Slovenia mentions the implementation of seven Stage I directives (see Table 4), it does not state which seven directives the Commission is referring to. As the Commission states that Slovenia's banking sector has some country-specific difficulties, it is particularly regretable that the legal framework is not described in more detail.

The very high *level of concentration* in applicants' banking sectors constitutes a main cause for concern for the Commission. Although this criticism is justified, we have to bear in mind that this characteristic stems mainly from historical developments. Commercial banks were initially established artificially: To introduce a two-tier banking system, most of the countries simply separated the former central bank into different parts. Moreover, as the banking sector develops and as the level of competition rises, among other things because of the presence of foreign banks, the degree of concentration tends to diminish.

The Commission also objects to the high level of *state participation* in the applicants' banking sectors as compared to the European average. Again, we principally share the Commission's concern with this defect, but we would put a bit more emphasis on the progress to be expected in the medium term after completion of the process of enterprise and banking privatization, which is clearly under way. Surprisingly, while the Opinion correctly states that the bank privatization process is "almost complete"[86]) in the case of Hungary, the Commission also underlines the importance of continued privatization.[87]) As only four of the majority state-owned banks had not yet been privatized at the time of the cutoff date, and as the Hungarian Privatization Agency had clearly committed itself to completing the privatization process, the Commission appears to have slightly overemphasized the importance of further privatization measures.

The *bad loan* problem of the applicants' banking sectors mentioned by the Commission in all but the Hungarian case cannot be examined separately from the problem of "bad" companies which have not yet reached a sufficient level of competitiveness. The governments of these countries usually have to take part in the consolidation of the banks and companies, which puts a burden on the state budget. Therefore, the problem of nonperforming loans cannot be seen as a weakness just of the banking sector, but also of the economy as a whole.

When it judged the competitiveness of banks, the Commission should have dealt with the question of *deposit guarantee schemes.* According to the "home country principle," the standards for deposit guarantees are determined by the legislation of the home country. Therefore, a deposit guarantee in the applicant countries logically gives foreign banks a competitive advantage in these markets, because it increases the customers' confidence in these credit institutions. Even in the case of Hungary, where the banking sector is quite developed, it will be difficult to raise the present amount of the deposit guarantee from currently HUF 1 million (approximately ECU 5,000) to the European level (ECU 20,000 from the beginning of 2000).

The Commission does not deal with the liberalization of *cross-border branching* in detail, although this step will be of crucial importance for the competitiveness of credit institutions within the Single Market. As this obligation of the Europe Agreement is a condition only for full membership in the Union, most of the applicant countries have not yet or only partially abolished the restrictions on the operation of foreign firms, including credit institutions through branches. OECD members have already undertaken to open their markets to foreign legal entities, so that foreign banks will also be allowed to open branches in these countries. However, the Commission does not mention the liberalization of cross-border branching at all in the case of the Czech Republic, unlike in the case of Hungary and Poland, where the Commission acknowledges liberalization. The OECD legal framework is not as strict as the relevant EU directive, therefore the harmonization with EU directives could necessitate further substantial adjustments of the banking legislation and of the operation of credit institutions in these countries. Estonia and Slovakia have also allowed foreign banks to open branches. However, whereas in the case of Estonia the Commission describes the equal competitive situation of branches compared with domestic banks, it does not say anything about the restrictions on branches of foreign banks in the case of Slovakia.

3.4.5 Liberalization of Capital Movements

It took incumbent EU members about 20 years to liberalize their capital movements. Most of the process of capital movements liberalization was completed during Stage One of European Economic and Monetary Union. This extended liberalization process on the remaining sensitive areas has recently accelerated because Stage Two is drawing to a close, and the freedom of capital movements is an obligatory and essential condition to join the third stage of EMU. Like the EU countries, who preferred step-by-step liberalization, most CEECs have chosen a rapid, but (in principle) gradual

opening of their capital markets. However, they have a much shorter period of time to prepare themselves to completely free capital movements. This process of liberalization is much more advanced for the three countries that are already OECD members, as they had to undertake the obligations of OECD membership, and for Estonia, where the process has basically been completed.

As mentioned earlier, the Commission distinguishes between the degree of capital movement liberalization in the Czech Republic, Hungary and Poland (see section 2.7 of this paper). A thorough analysis of the three countries' foreign exchange regulations, as they stand, raises some doubts whether such a differentiation is really justified. In fact, apart from minor differences, the main features of the current Czech, Hungarian and Polish foreign exchange systems are very similar.[88])

The Commission's assessment does not take into account certain foreign exchange regulation and policy aspects. In the Czech avis, there is no reference to the rather comprehensive safeguard clause on the introduction of a deposit requirement for a number of inward capital transactions.[89]) The Polish and the Hungarian laws have no such clauses. Furthermore, the assessment does not mention that the Czech National Bank imposed limitations on commercial banks' short-term foreign exchange positions toward nonresidents in August 1995, thus in effect putting a cap on such short-term inflows. Hungary and Poland have not adopted such measures to get a grip on capital inflows. Finally, it should be noted that progress towards liberalizing cross-border branching is much more pronounced in Hungary and, to some extent, in Poland than in the Czech Republic.

In a similar vein, the overall assessment of Slovenia's progress in liberalizing capital movements seems slightly too critical, especially by comparison to the assessments of others (for example, relative to the favorable assessment of Slovakia in this realm). Clearly, the capital controls introduced by Slovenia constitute a drawback and will have to be phased out over the medium run.[90]) Notwithstanding these controls, it should be noted that the country has made tangible overall progress toward liberalizing the capital account.

3.4.6 EMU Relations

The Commission's EMU-related observations cover all relevant issues in an appropriate and plain manner. One can subscribe to the gist of the analysis, which is well-guided and based on broad and accurately presented factual evidence. Still, a few remarks and minor qualifications on some specific issues appear to be warranted.

Two of these comments relate to consistency issues. First, as mentioned earlier, there are cases where formulations in Volume I of Agenda 2000 are somewhat different from the wording on the same issues in the individual country Opinions. This is true of the Commission's assessment on the perspectives for a simultaneous joining of EU and EMU by applicant countries and for the references to institutionalized exchange rate cooperation between the CEECs and the euro area upon enlargement.[91]) Probably, these incongruities do not imply differences in accentuation.[92])

Second, in reviewing intra-avis consistency, an assessment incongruity between Part B, Chapter 3.3, Economic and Monetary Union, and Part C, Summary and Conclusions, of the Opinions on Slovenia – and on Slovakia[93]) – has to be mentioned: It remains unclear whether the Commission expects Slovenia (and Slovakia) to meet the obligations for participation in EMU as pre-in countries until EU accession or not. Although this divergence presumably did not occur on purpose, it is nevertheless relevant, in particular as the assessment in the Summary and Conclusions, which is very much in the public eye, is less positive than the one in the detailed analytical section.

A second set of remarks pertains (more directly) to the substance of the Commission's assessment. Here, it is pertinent to take up the question of how realistic it is for applicant countries to accede to the European Union and the euro area at the same time. The Commission is right in assuming that none of the five countries will be likely to fulfill the Maastricht criteria on a sustained basis in the medium run due to structural weaknesses the candidate countries can presumably iron out only in the long run. On economic grounds, there is thus a good case to expect that participation in the euro area will follow only some time after EU accession, especially if the latter indeed takes place in the medium run, as the Commission surmises.

The issue, though, has a further dimension: From a Treaty point of view, there is a major obstacle to joining the EU and EMU simultaneously. This is due to the specific phrasing of the convergence criterion relating to exchange rate stability: It requires two years of formal ERM (after 1999: ERM II[94])) membership prior to entering the euro zone. Most Member States agree that actual exchange rate stability is not sufficient to fulfill this criterion. As EU membership is a precondition for joining the ERM, according to the Community rules as they stand, a country can, from a legal point of view, in fact join Stage Three of EMU at the earliest two years after having acceded to the European Union. Agenda 2000 does not touch upon this point, apparently because Stage Three of EMU still constitutes such a distant perspective for the applicant countries. Nevertheless, not discussing the matter might contribute to creating misconceptions on the part of the applicant countries.

As regards exchange rate policy cooperation, the Commission's position is clear in that the applicant countries are expected to participate in EU exchange rate arrangements. The newly acceding countries do not have the option of staying outside the institutionalized policy concertation in this area (perhaps apart from truly exceptional situations).[95]) Here, the question arises why Agenda 2000 does not refer explicitly to the ERM II, the exchange rate arrangement scheduled to come into effect in Stage Three of EMU.

Apparently, the Commission has chosen to refrain from specifically mentioning ERM II mainly because determining the full set of rules and procedures on exchange rate cooperation in the third stage of EMU and foreseeing future developments in the area during the period up to enlargement is perceived as difficult.[96]) Still, this circumspection does not imply that "anything goes" when it comes to defining the exchange rate arrangement applicable for the CEECs.

In fact, from today's perspective, it is reasonable to expect that the basic institutional arrangement provided for by ERM II will also be the framework of reference for the CEECs upon their accession to the European Union, even though any formal decision on this issue is still some time away. A number of considerations appear to support this judgment. To begin with, two clear goals are assigned to institutionalized exchange rate cooperation within Stage Three of EMU, namely supporting the convergence efforts of the pre-in countries and ensuring the smooth working of the EU Internal Market. These objectives are equally valid for incumbent Member States and for newly acceding countries, and they will in all probability remain defining parameters for EU exchange rate cooperation for the foreseeable future. In practice, this will pose a severe constraint on granting special ("more flexible") institutional treatment to the applicant countries in the field of exchange rate concertation. Moreover, there is no economic need for a further "softening" as compared to ERM II standards, which already display a considerable degree of flexibility: Advanced transition economies that meet the criteria for EU membership should typically be in a position to accommodate their legitimate needs for exchange rate flexibility within the normal boundaries of the ERM II.

A further remark relates to a certain imbalance in Chapters 3.3 of the individual country Opinions: While the Commission is fairly precise about the action that has to be taken to increase the effectiveness of monetary policy, it remains silent about what it perceives to be the implications of aligning the exchange rate regimes and policies of the candidate countries with the EU framework. Obviously, this is an issue which will need further elaboration fairly early in the remaining preaccession period.

Concerning the Commission's final assessment in the area of EMU, the judgment Agenda 2000 reaches on the Czech Republic, Estonia, Hungary and Poland appears to be fair. As regards Slovenia, the assessment in Part B of the Opinion would seem to be more in line with the country's overall performance in the relevant areas, in particular in a comparative (cross-country) perspective, than the less positive judgment in Part C, Summary and Conclusions.

4 The Preaccession Strategy Proposed by the Commission

In the "Agenda 2000" documents, the Commission proposes reinforcing the preaccession strategy for applicant countries. The comprehensive description can be found in Volume II of Agenda 2000. Also, each of the Opinions[97]) as well as Volume I of the Agenda[98]) mention some elements of the preaccession strategy.

The proposed preaccession strategy introduces three new instruments to strengthen the enlargement process. First, the Commission proposes to bring together the current and future forms of EU assistance into a single framework under the so-called *Accession Partnership.* The Accession Partnerships will be worked out by the European Commission in bilateral cooperation with each candidate country. On the part of each applicant, they will comprise a precise commitment, including an exact timetable, on a multiannual program to eliminate the deficiencies[99]) identified in the Opinions. On the part of the Union, the Partnership involves the mobilization and coordination of different financing sources both from within the Union as well as from international financial institutions.[100]) Interestingly, the Commission proposes annual financing agreements and an "accession conditionality," which implies a yearly evaluation of the implementation of the abovementioned program by applicants.

Generally speaking, we welcome the Commission's proposal to create a unified framework for accession assistance. However, it will be a very difficult task for the Commission to *coordinate the different financing instruments* not only within the European Union (PHARE programs, balance-of-payments loans, agricultural aid, Euratom loans and direct funding by the Structural Funds from the year 2000), but also with the international financial institutions (EIB, EBRD and the World Bank). Besides this, the Commission's suggestion that the legal form of the Accession Partnerships should be solely a *Commission decision* could turn out to be rather problematic: It implies that the Council would not be included in this key dimension of the preaccession process. Therefore, this suggestion is likely to be debated or even changed by the European Council. Moreover, the *administration* of the Accession Partnerships will require considerable personnel capacity both for the Commission and the respective applicant country. Therefore, we welcome the Commission's proposal to make use of the already existing *institutional infrastructure of the Association Agreements.* It is noteworthy that the Commission speaks about cooperation with association bodies, but very much stresses the role of the association *subcommittees.*[101]) This could be seen against the background that cooperation with the "high-level" association bodies (Association Council and Association Committee) would necessitate the involvement of the Council. Moreover, the Agenda 2000 documents remain silent on the relationship of accession negotiations and Accession Partnerships: How will these two instruments be interlinked, and how will coordination between the two be guaranteed?

The second instrument proposed by the Commission is the submission of an *annual report* to the European Council on the progress of all applicant countries. For this purpose, the Commission will evaluate the applicants'

progress in fulfilling the targets defined in each of the Accession Partnerships. According to the Commission, this instrument leaves the door open for nonrecommended candidates, because if an applicant is issued a positive progress report, the Commission will recommend the start of negotiations to the European Council.

We agree with the Commission that the annual progress reports are *an adequate instrument* to integrate the nonrecommended countries into the pre-accession process. However, like in the already published country recommendations, the contents of these reports will have a very strong *political and economic signaling function.* Therefore, the wording and any recommendation will have to be carefully weighed before the reports are made public. While the Commission clearly says that the reports give nonrecommended countries an opportunity to enter into negotiations, it remains silent on the possible consequences of a negative progress report for a country that has already started accession talks.

The third proposal made by the Commission is to set up a *European Conference,* a multilateral instrument of cooperation in the areas of common foreign and security policy as well as justice and home affairs. According to the Commission's proposal, the European Conference should bring together EU Member States and associated countries.[102]) Remarkably, this instrument is outlined exclusively in Volume I of Agenda 2000, although Volume II contains the detailed description of the entire preaccession strategy.

In our view, the European Conference could be very important because it can provide an opportunity for EU members to convene with EU aspirants on a multilateral basis. Moreover, it might be interesting to extend the topics of the European Conference further in order to incorporate other accession-related issues of a horizontal nature. This could also render superfluous the multilateral ad-hoc dialogue the Commission proposes, thus streamlining preaccession procedures. To this end, it might be worth considering organizing the European Conference not only at the head-of-state level, but also – in a regular and substantive manner – at a ministerial level.[103])

5 Concluding Remarks

In this paper, we have undertaken the exercise to analyze in detail the Opinions on the ten Central and Eastern European candidates for EU membership. We are convinced that an in-depth discussion of these documents is indispensable, as their importance for the future relations between the Union and the applicant countries will be far-reaching. They will not only serve as a starting point for the EU accession negotiations, but also provide the basis for the multiannual programs to be drawn up within the framework of the proposed Accession Partnerships.

The Commission's analysis of the candidate countries is comprehensive and on the whole very detailed. In general, its main lines are well-guided and based on accurately presented factual evidence. However, although the Commission did try to interlink the different subchapters of each Opinion, the documents generally raise the impression of being a "patchwork" of different chapters rather than one integrative document. Due to this

piecemeal approach, the analysis is not always fully congruous and displays some inconsistencies.

We conclude that the basic approach of the Commission to propose the Czech Republic, Estonia, Hungary, Poland and Slovenia for accession negotiations appears to be economically justified, although it does have a number of drawbacks. However, the integration prospects for the five candidates that are not recommended for starting negotiations will depend crucially on the implementation of the proposed preaccession strategy. In our view, it will be of particular importance that, as soon as the second-wave countries have fulfilled the criteria put forward by the Union they will be invited to join the negotiation process at any time. Moreover, as mentioned earlier, the recommendation of the Commission is not a binding proposal; the final decision can be taken exclusively by the European Council, most likely at the Luxembourg Summit in December 1997.

On the part of the present EU-15, successful Eastern enlargement will critically depend on the timely and adequate reform of the institutions within the Union, a matter which needs to be tackled regardless of enlargement, and on the efficient coordination of financial resources to support the approximation process.

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1 *All Foreign Research Division of the Oesterreichische Nationalbank; Ágnes Horváth is an economist from the Hungarian National Bank currently at the OeNB. The standard disclaimer applies.*
2 *The Agenda 2000 package comprises more than 1,500 pages and, apart from the ten country Opinions, includes a comprehensive document about the impact of enlargement on the Union and its policies as well as the future financial framework beyond the year 2000 (see Volume I, Communication: For a Stronger and Wider Union). Moreover, Volume II describes the proposed preaccession strategy in detail (see Volume II, Communication: Reinforcing the Pre-Accession Strategy).*
3 *For details about the history of the enlargement process so far, see Backé and Lindner (1996).*
4 *Countries are listed in alphabetical order in the paper to avoid ranking the applicants.*
5 *The official wording for this third criterion is the "ability to assume the obligations of membership, including adherence to the aims of political, economic and monetary union"; in the following it will be referred to as the "acquis criterion."*
6 *According to the Commission's proposal, the first "progress report" would be submitted in December 1998. See Agenda 2000, Volume II, Chapter IV.1.*
7 *See each of the ten Opinions, Chapter A.a, The Context of the Opinion.*
8 *See sections 2 and 3 of this paper.*
9 *See section 4 of this paper.*
10 *The questionnaires had to be submitted to the Commission by July 1996.*
11 *The expression "Opinion" and "avis" (the equivalent French term) are commonly used interchangeably in English texts.*
12 *See Agenda 2000, Volume I, Part Two I, Assessment on the Basis of the Accession Criteria.*
13 *See section 3 of this paper.*

14 See each of the ten Opinions, Chapter B.2.3.

15 See each of the ten Opinions, Chapter B.2.3.

16 See Agenda 2000, Volume I, Part Two I, Assessment on the Basis of the Accession Criteria.

17 The "White Paper on the Preparation of the Associated Countries of Central and Eastern Europe for Integration into the Internal Market of the Union" is part of the preaccession strategy for the associated countries of Central and Eastern Europe adopted by the Essen European Council in December 1994. The White Paper identifies the key measures in each sector of the Internal Market and suggests a sequence in which the approximation of legislation should be tackled.

18 The Commission has tried to present the legislative acquis for each area in a way that distinguishes so-called key measures from the total number of measures applicable, and also proposes a further breakdown of key measures into two levels of priority, namely Stage I measures (the highest priority) and Stage II measures (ranked immediately after the highest priority). In the field of capital movements, Stage I measures are, for example, the unconditional liberalization of current payments and medium- and long-term capital movements. Stage II measures are, for example, the approximation of legislation on short-term capital movements, the admission of and trade in money market securities, the opening of deposit accounts abroad, etc. Stage III measures are areas of the acquis that are not or only partly covered by the White Paper. They include many other important areas of the Union's activity such as agriculture, environment, energy, transport and social policy.

19 For the Czech Republic the Commission identifies agriculture, environment and energy as the sectors requiring "particular efforts, including investment." For Hungary "particular efforts" are needed in the fields environment, customs control and energy. For Poland the Commission recommends "particular efforts and investment" in the sectors agriculture, environment and transport. See Part C of the respective Opinions.

20 With further effort, Estonia should also be able to participate fully in the Internal Market in the medium term (according to Commission representatives, medium term is understood to mean a period of five years). Here the Commission names only the field environment where "particular efforts, including investment" are needed.

21 The Commission sees a need for reform in the sectors environment, employment, social affairs and energy.

22 Bulgaria and Romania need "substantial" reform.

23 According to each of the ten Opinions, the formal objective of the central bank is "not clearly stated" in Hungary, consists in "the strengthening of the currency" in Poland and "is … implicitly price stability" in Slovenia. See Chapter B.3.3 of the respective Opinions.

24 See the Opinions on Hungary and Poland, Chapter B.3.3, respectively.

25 According to the Commission, Latvia and Bulgaria (prior to the introduction of the currency board) had the standard range of indirect instruments, but they are "not fully effective." Slovakia's monetary policy is qualified as "quite effective in driving inflation down to single digit levels," although the Commission stresses the rather late introduction of indirect instruments. Romania gradually introduced indirect instruments, but "the central bank lacks any significant experience" in using them. Lithuania's currency board arrangement is qualified as generally successful.

26 However, as of October 1, 1997, the Council of the Bank of Slovenia introduced a nominal rate for tolar-denominated short-term securities with a maturity of up to 60 days.

27 See the Opinions on Estonia, Hungary and Poland, Chapter B.3.3, respectively.

28 While both countries had formally adopted a free float, the central banks nevertheless tried to intervene in the foreign exchange market. The Bulgarian central bank sometimes had limited scope for intervention due to the lack of foreign reserves, and the central bank of Romania introduced administrative restrictions to stem devaluation pressures.

29 See the Opinion on Hungary, Chapter B.2.2, The Existence of a Functioning Market Economy.

30 See the Opinion on the Czech Republic, Chapter B.2.2, Prospects and Priorities.

31 The Opinion on the Czech Republic does not provide an exact percentage of goods with administrative prices in the consumer basket.

32 Every year, the central bank had to submit the monetary policy guidelines for the following year to Parliament, where they had to be passed simultaneously with the budget act presented by the government. For details see Radzyner and Riesinger (1997).

33 While the central banks of Lithuania and Slovakia are qualified as "largely independent" from government in terms of the conduct of monetary policy and appointment procedures, Romania's central bank is only seen as "relatively independent." The independent status of the Latvian central bank is viewed as "largely guaranteed" by the legislation. Bulgaria's central bank, though "formally independent from the government" in terms of appointment procedures and the conduct of monetary policy, is criticized for having been influenced by the government in practice.

34 See the Opinion on Hungary, Chapter B.3.3.

35 However, the newly adopted Polish central bank law explicitly prohibits the central bank from financing the state budget deficit. This stipulation is even included in the new Constitution.

36 This weakness in central bank legislation is also identified in the Opinions on Bulgaria, Latvia, Lithuania, Romania and Slovakia. See Chapter B.3.3 of the respective Opinions.

37 The definition of this maximum amount varies from country to country. For details see Radzyner and Riesinger (1997).

38 See each of the Opinions, Chapters B.2.1, Progress in Economic Transformation, Economic Structure, Financial Sector; B.2.2, The Existence of a Functioning Market Economy, The Capacity to Cope with Competitive Pressures and Market Forces, Prospects and Priorities; B.2.3, General Evaluation; B.3.1, The Free Movement of Services, The Free Movement of Capital; B.3.3, Economic and Monetary Union; B.4.2, Key Areas for Implementation of the Acquis (Single Market).

39 See the Opinion on Hungary, Chapter B.3.3, Current and Prospective Assessment: "it is important that the privatisation of commercial banks continues and that competition in the banking sector is increased in order to enhance the efficiency of the transmission mechanism and to increase the central bank's ability to control monetary aggregates."

40 The Hungarian Banking and Capital Market Supervisory Authority and the Polish General Inspectorate for Banking Supervision.

41 In September 1997, the Romanian central bank announced that it would take on the obligations under Article VIII, but the official declaration did not take place until mid-November 1997.

42 Consequently, the field of capital account liberalization is not mentioned in Part C, Summary and Conclusions, of the Opinion on Estonia.

43 The Czech Republic became a member of the OECD in December 1995, Hungary in May 1996 and Poland in November 1996.

44 See each of the ten Opinions, Chapter B.3.3.

45 See each of the ten Opinions, Chapter B.3.3. The statement of Agenda 2000, Volume I, Chapter II.1.3 on the same issue is the following: "It is unlikely that the applicants will be able to join the euro area immediately" upon entering the European Union, as structural reforms will not advance far enough during the preaccession period to ensure sustained macroeconomic stability.

46 See previous chapters for details.

47 In order to guarantee the effectiveness of monetary policy cooperation, the newly acceding Member States will have to ensure that "monetary policy... be conducted with market-based instruments and ... [that it] be 'efficient' in transmitting its impulses to the real economy." The key to achieving this is further financial sector reform.

48 In Chapter B.3.3 of each of the ten Opinions, the reference to institutionalized exchange rate policy coordination is the following: "All Member states shall ... be in a position to stabilise their exchange rates in a mechanism yet to be decided." According to Agenda 2000, Volume 1, Chapter II.1.3, the newly acceding countries "are expected to participate in an exchange rate mechanism and avoid excessive exchange rate changes."

49 In the case of Hungary, there is no reference to the financial sector, but the Commission sees a need for maintaining the stability orientation of monetary and exchange rate policies. The latter remark can also be found in the Polish avis. The Opinion on Estonia lauds the country's central bank legislation, but it remains somewhat open about whether the Commission reasons that Estonia has already fully completed legal harmonization in this area.

50 See the Opinion on Slovenia, Chapter B.3.3 and Part C. The Commission's assessment of Slovakia is of a very similar content and structure as the one of Slovenia. In the case of the other four applicants, the Commission sees problems, in the case of Bulgaria even serious problems, if these states were to take part in the third stage of EMU as pre-in countries in the medium run.

51 Part C, Summary and Conclusions, states that "prices have been liberalised to a very large extent" in Estonia. Whereas Chapter B.2.1, Price Regime, concludes that administratively priced goods "make up some 25% of the basket on which the consumer price index is calculated" and "administrative decisions ... can therefore have a sizeable impact on month-to-month inflation rates."

52 For example the Opinion on the Czech Republic states – rather critically – in Chapter B.2.1, Progress in Economic Transformation, that "the state still has a majority or significant stake in a number of large enterprises and, most importantly, in the four main banks." The same information is interpreted in a much more positive way in Chapter B.2.2, The Existence of a Functioning Market Economy: "private ownership has been extended, and the privatisation process is almost complete with only the main banks and some 60 strategic enterprises left in state hands."

53 *While the country Opinions conclude that five applicants (the Czech Republic, Hungary, Poland, Slovenia and Slovakia) will have the capacity to cope with competitive pressures in the medium term, Agenda 2000, Volume I, states that only two countries (Hungary and Poland) will fulfill this criterion in the medium term "provided they stay on their current course. Three others (the Czech Republic, Slovakia and Slovenia) should be in the same position on condition that they strengthen their efforts and avoid policy reversals." See Chapter B.2.3 of the respective Opinions and Agenda 2000, Volume I, Part Two, Chapter I.2.*

54 *See Agenda 2000 Volume I, Part Two, Chapter I, Assessment on the Basis of the Accession Criteria.*

55 *Ilzkovitz and Daviddi (1996).*

56 *The Commission requires "macroeconomic stability ... including adequate price stability and sustainable public finances and external accounts." For details see Agenda 2000, Volume I, Part Two, Chapter I.2, The Existence of a Functioning Market Economy.*

57 *The Commission's list of subconditions further comprises the "free interplay of market forces, the liberalisation of prices and trade," the removal of "significant barriers to market entry (establishment of new firms) and exit (bankruptcies)," the existence of a "legal system, including the regulation of property rights" and the existence of a sufficiently well-developed financial sector "to channel savings towards productive investment." See Agenda 2000, Volume I, Part Two, Chapter I.2, The Existence of a Functioning Market Economy.*

58 *The Commission also mentions the necessity of a "broad consensus about the essentials of economic policy," a condition which certainly has a political dimension. See Agenda 2000, Volume I, Part Two, Chapter I.2, The Existence of a Functioning Market Economy.*

59 *The Commission speaks about "a sufficient amount, at an appropriate cost, of human and physical capital, including infrastructure (energy supply, telecommunication, transport, etc.), education and research, and future developments in this field," and about an increased proportion of small firms "partly because small firms tend to benefit more from improved market access, and partly because a dominance of large firms could indicate a greater reluctance to adjust." See Agenda 2000, Volume I, Part Two, Chapter I.2, The Capacity to Withstand Competitive Pressure and Market Forces within the Union.*

60 *The Commission refers to "the extent to which government policy and legislation influence competitiveness through trade policy, competition policy, state aids, support for SMEs, etc." as well as to "the degree and the pace of trade integration a country achieves with the Union before enlargement." See Agenda 2000, Volume I, Part Two, Chapter I.2, The Capacity to Withstand Competitive Pressure and Market Forces within the Union.*

61 *See the Opinion on Slovakia, Chapter B.2.2.*

62 *The main deficiency identified by the Commission is that a full prohibition of direct budget financing by the central bank, as required by the Maastricht Treaty, is still not in place. For details see section 2.4 of this paper.*

63 *The Baltic States concluded a free trade agreement (the Baltic Free Trade Agreement) in 1995. In January 1997 this was supplemented by an agreement on agricultural products eliminating all tariffs and quotas on mutually traded agricultural goods.*

64 *Reuters, BBC Monitoring Service, Riga, July 22, 1997.*

65 *Reuters, BBC Monitoring Service, Vilnius, July 22, 1997.*

66 *Reuters, BBC Monitoring Service, Bucharest, July 26, 1997.*

67 *The Central European Free Trade Association (CEFTA) was founded in 1991 and at present comprises the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia.*

68 *See Oostlander (1997).*

69 *This proposal was made by Kinkel on the occasion of the informal meeting of the EU foreign ministers in Bad Mondorf, on October 25 and 26, 1997. See Reuters, October 27, 1997.*

70 *As a case in point, the Czech currency crisis is desribed in detail in two different subchapters of the same Opinion. See Chapter B.2.1, Foreign Exchange Regime and Chapter B.3.3, respectively.*

71 *Latvia's monetary policy is qualified as "effective in reducing inflation"; Slovakia's monetary policy is seen as "quite effective in driving inflation down to single digit levels." See Chapter B.3.3 of the respective Opinions.*

72 *See the Opinion on Slovenia, Chapter B.3.3.*

73 *For a more detailed analysis see, for instance, Radzyner and Riesinger (1996).*

74 *See the Opinion on Latvia, Chapter B.3.3.*

75 *See International Monetary Fund (1997).*

76 *In Chapter B.3.3, Current and Prospective Assessment, the Commission states that "the rising current account deficit, while not being an immediate threat for the stability of the exchange rate, has provoked a currency crisis of which the effects on the Czech economy are still unclear." See the Opinion on the Czech Republic.*

77 *See Chapter B.2.2, Prospects and Priorities, in the respective Opinions.*

78 *The Hungarian currency basket comprises the ECU (70%) and the U.S. dollar (30%), the Polish basket consists of five currencies (45% U.S. dollar, 35% Deutsche mark, 10% pound sterling, 5% French franc, 5% Swiss franc) and the Slovak basket comprises the Deutsche mark (60%) and the U.S. dollar (40%).*

79 *For details see Krzak (1996).*

80 *See the Opinion on Poland, Chapter B.3.3, Current and Prospective Assessment.*

81 *See the Opinion on the Czech Republic, Chapter B.3.3, Current and Prospective Assessment.*

82 *See, for example, the statement by Latvian Prime Minister Skele. Reuters, BBC Monitoring Service, Riga, July 22, 1997.*

83 *The paper by Radzyner and Riesinger (1997) comes to similar conclusions.*

84 *For details see Radzyner and Riesinger (1997).*

85 *See the Opinion on Estonia, Chapter B.3.3, Current and Prospective Assessment.*

86 *See the Opinion on Hungary, Chapter B.2.*

87 *See the Opinion on Hungary, Chapter B.3.3, Current and Prospective Assessment.*

88 *For details see Backé (1996). Hungary's recent steps towards further liberalization (which are mentioned in the avis on Hungary) have led to even further convergence of regulations regarding capital account convertibility in the three countries.*

89 *According to the Czech Foreign Exchange Act, the safeguard clause can be applied with respect to proceeds from the issue of debt instruments, inward financial credits, inward borrowing through money market instruments, and deposits by nonresidents with Czech banks.*

90 *In fact, the Bank of Slovenia has already started this process by easing the regulations on custodian accounts in June 1997 (i.e. shortly after the avis cutoff date).*

91 *See section 2.8 of this paper.*

92 *In general, such relatively minor discrepancies are practically unavoidable in any exercise involving a major coordination and concertation effort to be carried out under significant time pressure.*

93 *As pointed out earlier, the content and structure of the Opinion on Slovakia is similar to that of Slovenia in this field and therefore contains similar discrepancies: While the Commission sees "no problems" for Slovakia to join EMU in the medium term in Chapter B.3.3, it states in Part C, Summary and Conclusions, that Slovakia's participation in EMU "could present some difficulties" and explicitly refers to the incompatibility of central bank legislation.*

94 *This is the arrangement that will govern exchange rate relations between the euro area and the pre-in countries after 1999.*

95 *This implies a certain differentiation between incumbent Member States that will not join the euro area from the outset and the newly acceding countries: Both groups are expected to join EU exchange rate arrangements. However, for the incumbents this is qualified by the fact that, for them, participation in ERM II will be voluntary.*

96 *The principles and main features of ERM II were approved only at the European Council in Amsterdam in June 1997 and thus just before Agenda 2000 was finalized. The second pillar of the mechanism, its operating procedures, are still to be laid down. Furthermore, it is clear that one cannot rule out that some features of ERM II will be developed further in the period up to the next round of EU widening. Finally, none of the incumbent Member States (nor any of the applicant countries) has formally adopted an elaborate position on the design of exchange rate arrangements after enlargement (in particular on the extension of ERM II to the East), and the ECB, which will have a key role to play in these matters, will only come into being in May 1998. Against this backdrop, it appears sensible for the Commission to have maintained, in Agenda 2000, a relatively low profile on the issue.*

97 *See each of the Opinions, Chapter A.b, The Pre-Accession Strategy.*

98 *See Agenda 2000 Volume I, Part Two III.2, Reinforcing the Pre-Accession Strategy.*

99 *The program will mainly refer to the adoption of the acquis, but also to the strengthening of democracy, macroeconomic stabilization and nuclear safety. See Agenda 2000, Volume I, Part Two III.2, Reinforcing the Pre-Accession Strategy and Volume II, Chapter IV.1.*

100 *See Agenda 2000 Volume I, Part Two III.2, Reinforcing the Pre-Accession Strategy and Volume II, Chapter III. A–D.*

101 *See Agenda 2000 Volume II, Chapter IV.2, Europe Agreements.*

102 *The wording "associated countries" would also comprise Cyprus and Turkey, which concluded Association Agreements with the Union in 1972 and 1964, respectively. However, a final decision on Turkey's participation in the European Conference had not yet been taken as of the date of writing.*

103 *According to the Commission, the "Conference would meet each year at the level of Heads of State or Government and the President of the Commission and, when necessary, ministerial level." See Agenda 2000, Volume I, Part Two V.*

Editorial close: November 14.