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Eesti Pank in the European Integration Process

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Eesti Pank

For Estonia, active striving to the European Union (EU) started shortly after regaining independence in 1991. The Accession Agreement was signed in 1995 and in the same year a formal membership bid was put on the table. In 1995, the target of full membership "only" in 2002-2003 seemed like a very long time away, but looking back at the past ten years, one feels that the time has been flying. It has been very interesting, fast-paced development for Estonia, and Eesti Pank – the national central bank – has played an active and important role in the European integration process. With every new goal there have been new, higher challenges. This paper describes how Eesti Pank has met these challenges during 1995–2005.

1. Getting Ready for EU Membership

EU membership – "restoration of Estonia's place in Europe" – was a clear goal when Estonia regained its independence from the Soviet Union occupation. When the Accession Agreement was signed in 1995, Eesti Pank became an active participant in various EU committees and in the domestic coordination. In 1996, the Government created the Council of Senior Civil Servants and the central bank was also represented there at high level. This ensured good information flow and the ability to influence preparations in areas close to the central bank's heart: economic policy issues, free movement of capital, financial services. The Estonian Government delegation for the EU accession negotiations was formed in 1997 (the negotiations started formally in March 1998) and Eesti Pank participated in the negotiations on four chapters: Free movement of services, Free movement of capital, Economic and Monetary Union (EMU), and Institutions. Owing to the liberal economic policy, these were not difficult chapters to negotiate for Estonia. However, there was a lot of EU legislation to be analysed and then implemented in Estonian law. Eesti Pank, even though small in comparison to other central banks in Europe, was well resourced and staffed when compared to several key ministries and therefore the various reports, draft legislation and economic analyses were warmly welcomed by the government institutions.

It is interesting to note that while some EU Commission officials openly suggested that a country should not worry too much about fulfilling the Maastricht criteria before entering the EU, and for example having a budget deficit larger than 3% would also be acceptable, the Estonian Government decided early on against such "handicap". Obviously, with the currency board arrangement in place it was most important that the fiscal policy remained conservative and Eesti Pank's advice on this issue was generally appreciated and heard.

Change in legislation was one of the most visible elements of the EU accession process and Eesti Pank played its part there. The revision of the Central Bank Act was naturally of special interest. The key goal in this process was to maintain the independence of Eesti Pank – a somewhat tricky task with the Parliament handling dozens of new laws in parallel in order to harmonise the legislation with the Community law. Moreover, major changes in legislation rose questions about how to maintain quality in such a fast implementation process, how to ensure quality of translation, and how to contain "over-eagerness" to adopt everything without first trying to adjust directives to suit better the Estonian circumstances. The first years in the EU have shown that the preparations for the EU accession were of high quality and both the legal bases as well as the implementing agencies were generally well prepared for the membership in the Union.

2. Participation in the EU Decision-Making Process

When Estonia became EU member in May 2004, the representatives of Eesti Pank and the Government had been participating for about 9–12 months in various EU committees, councils and working groups as observers. Membership of the ESCB brought about participation in the major share of such committees and working groups, but the representatives of Eesti Pank take part also in the Council and Commission committees and working groups. Altogether about 70 committees and working groups entailed a great increase in the workload for bank staff, whereas the number of employees (around 240) has not grown. The key people involved – the Governor and Deputy Governors, heads of departments and units, and key specialists – have been able to cope with new tasks very well, but it has taken some time to adjust. And we are well aware that with membership in the euro area this workload will increase even further. In Eesti Pank we have seen a clear increase in knowledge and understanding of relevant issues, which, in turn, has facilitated more effective participation in the committees and working groups. Overall, the EU membership has raised the requirements for analysis and know-how, because many topics have been new or only relatively little known.

A key to successful participation in the EU decision-making process is good preparation and coordination. While all the departments are responsible for their own areas, the Department of International and External Relations has the role of the coordinator. Among its tasks is the preparation of the management's EU coordination meetings, which take place every two weeks. At those meetings the management takes stock of the bank's work in Europe and discusses the main priorities and positions for the forthcoming meetings. Since 2001, Eesti Pank has also assigned a representative to the Estonian mission to the EU, whose main areas of responsibility are the Economy and Finance Council (ECOFIN), financial services and issues related to the euro changeover preparations.

Eesti Pank participates in the Government's Coordination Committee (successor of the Council of Senior Civil Servants which played a key role in preparing for EU membership) that coordinates the positions for all Council meetings before the Cabinet formally adopts them. For informal discussion and coordination of economic policy issues, Eesti Pank chairs a special high-level meeting of Ministries of Finance and Economy as well as the representatives of the Prime Minister and President's office. This forum allows to discuss potential policy responses to various developments before they are made public, to exchange views on the main developments and to draft common positions on key economic policy issues in Europe, such as the reform of the Stability and Growth Pact.

3. Getting Ready for the Euro Area

Fast accession to the euro area is a natural choice for Estonia, as our currency has been pegged to the German mark and later on to the euro for more than 14 years. With a prudent fiscal policy and the economy growing well, the criteria for entry should not pose any major problems for Estonia. However, there have been some "Estonia-specific" challenges already prior to the EU accession – for example, the discussion about the compatibility of currency boards with the New Exchange Rate Mechanism (ERM II) (we know this debate ended with the decision that a double regime shift prior to the adoption of the euro was neither required nor advisable, and thus Estonia joined the ERM II with a standard fluctuation band and with maintaining the currency board arrangement as a unilateral commitment). Estonian Government's tiny debt posed a different problem – lack of a comparable indicator for the interest rate criterion. Fortunately, the idea that in order to meet the formal Maastricht criteria the Government should issue a meaningless (and unnecessary) 10-year bond has been rejected. A few years before the EU accession there was also a debate in Estonia about unilateral euroisation, but upon the advice of Eesti Pank the Government decided that the adoption of the single currency should fully respect the EU rules.

The convergence reports of 2004 were quite positive about Estonia's euro aspirations and the Government and Eesti Pank have maintained January 1, 2007 as the target date for the changeover. The surge in oil prices has affected the inflation in recent months, but despite a challenging situation the Government remains committed to the goal.

Obviously, the changeover entails a lot of practical preparations. The Government established a Changeover Committee in January 2005 and several working groups to lead the practical work. Eesti Pank is a member of the

Changeover Committee, chairs the Credit Institutions working group, and participates actively in most others as well. A key area is naturally communication. As the opinion polls show, one of the main concerns of the general public is the possible rise in prices. Even though the statistics do not reveal notable price increases stemming from the introduction of the new currency, this perception is very strong also in the present euro area and gives a lot of food for the euro sceptics in Estonia.

4. Challenges on the Domestic Front

When times are good as they have been in Estonia – with strong and stable economic growth without setbacks since the Russian crisis in 1998 – the role of the central bank becomes less visible to the general public. Although the EU accession brought along new tasks and the membership in the Eurosystem will add to that, there are questions about the bank's future role. Some ask quite bluntly – why do we need a central bank when we have the euro and the European Central Bank (ECB)? Therefore, one of the challenges ahead is better communication of the bank's mandate and role in the European System of Central Banks (ESCB). One of the points made is that unlike the countries with floating exchange rate regimes, Estonia will not have to give up independent monetary policy. On the contrary, in the Eurosystem Eesti Pank will take part in the decision-making on issues that are already affecting Estonian economic environment but where we have no say at the moment.

One of the questions asked is whether the current economic success and the supporting conservative policies will continue. Estonian politicians who have generally supported tight fiscal policy are quick to point out the current state of fiscal affairs in many euro area economies. It would probably be tempting to be less stringent once inside "the club" and thus the central bank will need to stay alert and vocal if this becomes the case.