EUROPEAN PARLIAMENT

TASK FORCE
on
Economic and Monetary Union

Briefing 38

EMU and Enlargement

Briefing prepared by the Directorate-General for Research
Economic Affairs Division

The opinions expressed are those of the authors and do not necessarily reflect the position of the European Parliament

In applying for membership of the European Union, Cyprus and ten countries of Central and Eastern Europe have endorsed all the objectives of the Treaty, including EMU. However, the applicants may not be able to join the Euro area immediately upon accession.

Luxembourg, 11 November 1997 PE 167.008

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Introduction

The European Council at Copenhagen in June 1993 agreed that Cyprus, together with the associated countries in central and eastern Europe that so wished, should in principle be able to negotiate entry into the European Union. Accession would take place as soon as a country could satisfy a number of economic and political conditions:

- ♦ *stability of institutions guaranteeing democracy, the rule of law, human rights, and respect for and protection of minorities,*
- ♦ *the existence of a functioning market economy, as well as the capacity to cope with competitive pressure and market forces within the Union; and*
- ♦ *the ability to take on all the obligations of membership, including adherence to the aims of political, economic and monetary union.*

Since then, besides Cyprus, all ten associated countries of central and eastern Europe (Poland, the Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Slovenia, Estonia, Latvia and Lithuania) have formally applied for membership. The Council has initiated the procedure of consulting the Commission, in accordance with Article O of the Treaty on European Union.

The Madrid European Council in December 1995 reaffirmed that the decisions necessary to start negotiations with the candidate countries should be taken in the six months following the conclusion of the Intergovernmental Conference leading to the Treaty of Amsterdam, and according to its results. The Conference also invited the Commission to express its opinion about the different candidates as soon as possible after the Intergovernmental Conference and to publish a general document on the enlargement.

The **Agenda 2000 Communication**, published by the Commission on the 15th of July 1997, deals with all the political and economic issues of the enlargement of the European Union. After explaining the fundamental problems and perspectives of a wider and stronger Union (vol. I), and estimating the main effects of enlargement on the Union’s policies (vol. II), the Commission examines the different applications for accession and the main questions they raise. A timetable for opening negotiations with the various applicants is also proposed.

Choice of countries

The first area of dispute is the choice of countries for the "first wave" of negotiations - assuming that these will not start with all applicants in parallel. Besides the case of Cyprus, the Commission has expressed a favourable verdict on Poland, the Czech Republic, Hungary, Estonia and Slovenia.

Mr Hans van den Broek, Dutch Commissioner in charge of enlargement, resisted pressure from inside and outside the Commission to restrict the short-list to the Czechs, Poles and Hungarians, who had already been invited to join NATO. Denmark, Finland and Sweden are pressing for accession negotiations to begin with all ten applicants. This appears more in support of the two disappointed Baltic States of Latvia and Lithuania than of Bulgaria, Romania and Slovakia.

The Commission has recognised the satisfactory economic development reached by Cyprus, which has a very low unemployment rate (2,5%), a moderate inflation rate (3%), and a national debt at just 53% of GNP.

It also believes that the applicant countries of central and eastern Europe have made considerable progress in the transition to a market economy, although their economic situations vary considerably. The break-up of the CMEA (commonly called the "Comecon"), the former communist trading bloc, and the beginning of market reforms, constituted a major initial shock for all. For some, this was aggravated by severe disequilibrium at the outset, while others inherited comparatively stable conditions and higher standards of living.

Reform has also taken a different course from country to country, and has benefited from wider support in some countries than in others. Despite this, policy has proved relatively constant even when governments have changed.

From an economic point of view, the Commission finds that five applicant countries (the Czech Republic, Estonia, Hungary, Poland and Slovenia) can be considered functioning market economies, even if some important features still need to be further developed. Hungary and Poland, in particular, are considered capable of withstanding the competitive pressures which they are likely to face within the Union. The Czech Republic, Estonia and Slovenia should be in the same position before long.

The other applicants (Romania, Bulgaria, Latvia, Lithuania and Slovakia) have made substantial progress, especially in recent times, and should be capable of withstanding competitive pressures within the Union early in the 21st century. For the moment, the Commission decided not to include them in the group of applicants with which to start direct negotiations.

The final choice of applicant States with which to start negotiations, however, will be made at the EU summit in December 1997.

Other enlargement issues

The second contentious issue is finance. The Commission claims that enlargement can be funded without any real increase in EU spending beyond the ceiling of 1.27% of EU Gross Domestic Product established for 1999. Net recipients from the EU budget - and in particular from the Cohesion Fund - such as Spain, are sceptical. Yet the British, French, German and Dutch governments are adamant that there should be no increase in national budgetary contributions.

A third issue is the length of the negotiations. The Commission’s working hypothesis is that the first wave of new members will enter the Union in 2002. But this will depend heavily on the EU’s internal agenda. The successful launch of EMU Stage 3 is almost certainly a precondition for expansion eastwards.

Fourthly, constitutional reform - a streamlined Commission, a rebalancing of power between small and large Member States and more majority voting - seems necessary to prevent a paralysis in decision-making.

Finally, and also highly contentious, is the issue of transition periods: how long the new Member States will have to wait before enjoying the same rights and privileges as the existing member States. Agenda 2000 declares that transition periods may be necessary, but should be limited in scope and duration. If the periods are too long, the effect will be to create two tiers of EU membership.

Monetary Union

It is in this context that the speed with which the new Member States can also become full members of the Euro area will be significant.

Stage 3 of EMU is likely to start on 1st January 1999 with ten or eleven full participants. Four Member States - Denmark, Greece, Sweden and the UK - are virtually certain to remain outside.

In the case of Greece, eventual membership depends on progress in fulfilling the economic convergence criteria established by the Maastricht Treaty. Denmark and the UK - both of which fulfill the criteria - have an "opt out", pending a political decision to join. In both cases a prior referendum will be necessary. Sweden has no formal opt-out[1], but has taken the position that EMU membership will depend upon a positive vote in the Swedish parliament.

There is nevertheless a strong possibility that most or all of these countries will fully join EMU in 2002, when Euro notes and coins come into circulation.

Meanwhile, those countries still outside the Euro area may link their currencies to the Euro through the reformed Exchange Rate Mechanism. Sweden and the UK, however, have so far taken the position that this should be optional, and are initially unlikely to do so. One of the conditions for full EMU membership is, nevertheless, two years of prior exchange rate stability.

Depending upon timing, therefore, the new Member States of the EU will find the following monetary situation:

- most - and perhaps all - existing Member States fully within the Euro area;
- some, however, possibly still outside through failure to fulfill the convergence conditions, or through continued exercise of an opt-out;
- the currencies of these "out" countries linked to the Euro through ERM2; but not necessarily.

[1] Formally, any Member State other than Denmark and the UK which meets the criteria is *obliged* to join the monetary union.

Economic Convergence

New Member States' participation in the Euro area will be judged on the same basis as current EU Members: i.e. that of the Maastricht convergence criteria.

According to the Commission, the current economic situation of the applicant states will not allow them to enter EMU Stage 3 in the short run. They will nevertheless have to adopt the *acquis* of Stage 2 immediately.

Under Article 109E, they will have to have completed liberalisation of their capital movements, and will be obliged to pursue disciplined and responsible monetary and fiscal policies. Economic policy will be subject to "multi-lateral surveillance" and to coordination. Even outside ERM2, exchange-rate policy must be treated "as a matter of common interest".

Admittance into the Euro area will then depend upon the degree of "sustainable convergence" that has taken place in terms of inflation, interest rates, budgetary and debt position and exchange rates. Real economic performance will also be taken into account: in particular, economic growth, unemployment rates, and trade and current account balances.

Finally, the central banks of the new Member States will have to be fully independent and follow a primary objective of price stability.

a) Inflation

High inflation rates have been one of the less desirable consequences of transition to a market economy in former socialist republics. Before 1990, inflation was a phenomenon known only in Poland and Hungary, the countries which first reformed their economies. Others maintained a low economic growth with low inflation rates.

A shown in Table 1, inflation rapidly reached very high levels in all the applicant countries after 1990. Only when the first structural reforms began to produce effects did the rates start to slow down.

The immediate inflation targets suggested for these countries illustrate the distance which has to be travelled before convergence with the EU average[2] (currently 1.8% p.a.). According to R. Dornbush and S.Fischer, it would be desirable for the countries of Eastern Europe not to exceed a rate of "moderate inflation". This they define as being between 12% and 18%[3].

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[2] It is assumed that the single inflation rate for the Euro area as a whole will be the reference point rather than the "three best performing Member States" currently applied.

[3] D. VELO, *L'adesione dei paesi dell'Est europeo all'Unione Europea: l'integrazione monetaria e finanziaria*, Cacucci, Bari 1996.

The World Bank, on the other hand, has declared that it would be better to reach and maintain a single-figure rate of inflation[4]. Yet at the moment this seems a possibility only for the Czech Republic, Slovenia, Slovakia and, probably, Poland and Latvia.

Table 1: Inflation rates in the applicant countries (1990-1996)

COUNTRY	1990	1991	1992	1993	1994	1995	1996
Cyprus	4.5	5.0	6.5	4.9	4.7	2.6	3.0
Poland	585.8	70.3	43	35.3	32.2	27.8	19.9
Hungary	28.9	35	23	22.5	18.8	28.2	23.6
Czech Rep.	9.7	56.5	11.1	20.8	10	9.1	8.8
Slovenia	549.7	117.7	201.3	32.3	19.8	12.6	9.7
Estonia	–	–	1,076	89.8	47.7	29	23.1
Romania	5.1	170.2	210.4	256.1	136.7	32.3	38.8
Slovakia	10.4	61.2	10	23.2	13.4	9.9	5.8
Latvia	10.5	172.2	951.2	109.2	35.9	25	17.6
Lithuania	9.1	216.4	1,020.8	410.2	72.2	39.6	24.6
Bulgaria	23.8	338.5	79.4	56.1	87.1	62.1	123

Source: Commission and Government Planning Bureau of Cyprus

b) Interest rates

During recent years, high levels of inflation in the ex-socialist countries have been reflected in high interest rates, both short and long[5].

Table 2: Interest rates in some applicant countries (1993-1996)

COUNTRY	1993	1994	1995	1996
Poland	35.3	32.8	33.5	26.1
Hungary	–	25.4	27.4	32.6
Czech Rep.	14.7	13.12	12.8	12.54
Slovenia	49.61	39.42	24.84	19.3
Estonia	27.3	23.1	16	13.7
Slovakia	8.02	9.32	9.01	6.18
Latvia	86.36	55.86	34.56	25.78
Lithuania	91.9	62.3	27.1	16

Source: Commission

4 The World Bank Economic Review, n.1, 1993, pp.1-44.

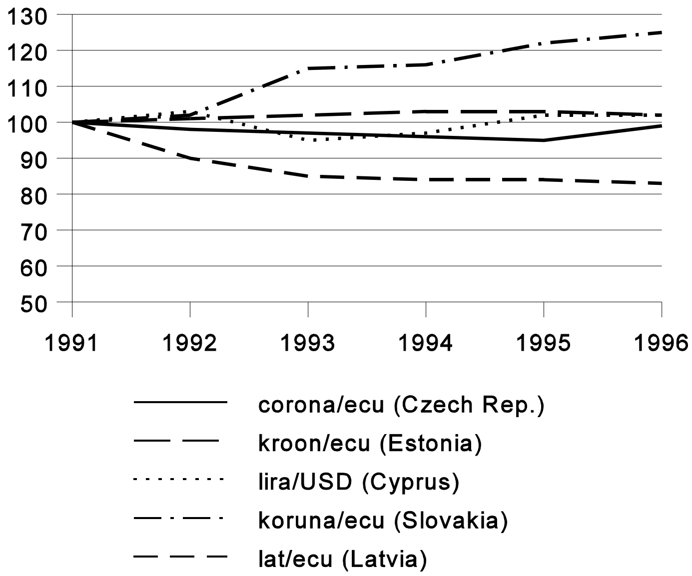
5 Data on Cyprus, Romania and Bulgaria are not available.

Only the Czech Republic, Slovenia, Estonia, Slovakia and Lithuania have a structure of interest rates within striking distance of meeting the convergence criteria. Short-term rates within the Euro area are unlikely to be above 4 - 5%, and long rates unlikely to be more than a point or two higher.

c) Exchange rates

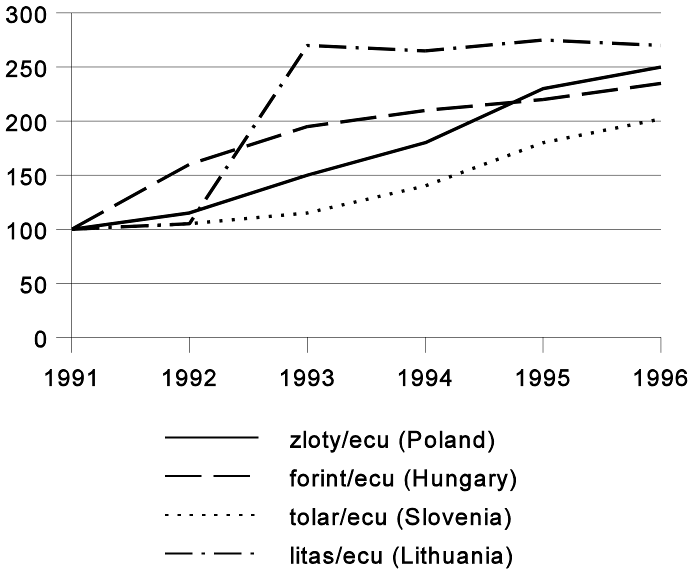
The following charts illustrate the evolution of the average exchange rates between ecu and the currencies of the applicant countries during the period 1991-1996.

Chart 1: Exchange rate in the Czech Republic, Estonia, Cyprus, Slovakia and Latvia 1991-1996 (1991=100)



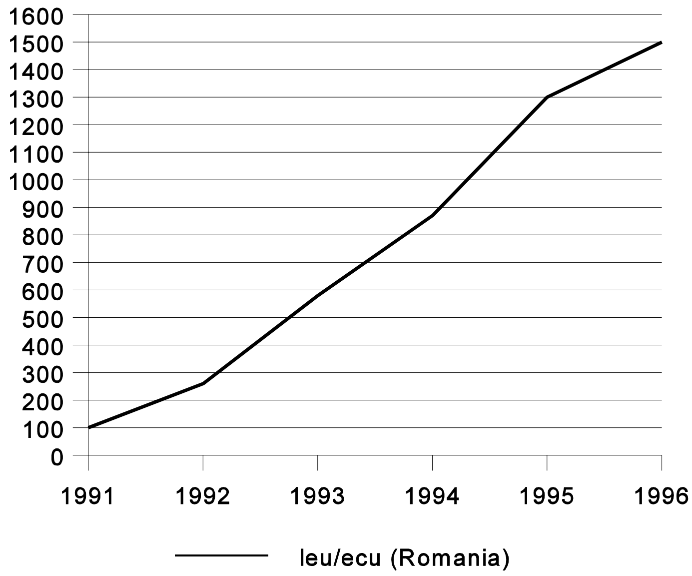
Source: Commission

Chart 2: Exchange rates in Poland, Hungary, Slovenia and Lithuania 1991-1996 (1991=100)



Source: Commission

Chart 3: Exchange rate in Romania 1991-1996 (1991=100)



Source: Commission

The applicant states thus fall into three groups.

- ♦ The currencies of the Czech Republic, Estonia, Cyprus, Slovakia and Latvia have been relatively stable, their exchange rates fluctuating within limited margins.

- ♦ The Polish *zloty*, the Hungarian *forint*, the Slovenian *tolar* and the Lithuanian *litas* have experienced continuous, but moderate, devaluation.

- ♦ The Romanian *leu*, on the other hand, has undergone continuous and rapid devaluation.

Of the countries recommended for the first round of EU membership negotiations, the Czech Republic, Estonia and Cyprus are therefore best-placed to join EMU from an exchange-rate point of view.

d) Budgetary positions

Most applicant countries were able to make considerable improvements in their budgetary positions in the early 1990s, largely through drastic cuts in public subsidies. After the first few years, however, economic recession caused a rapid fall in tax revenues and a consequent increase of budget deficits.

Table 3: General Government deficits as a percentage of GDP in the applicant countries, 1993-1996.

COUNTRY	1993	1994	1995	1996
Cyprus	-2.4	-1.5	-1.3	-2.9
Poland	–	–	-2.4	-1.9
Hungary	-7.5	-8.4	-6.1	-3.8
Czech Rep.	–	0.4	-1.4	-1.3
Slovenia	—	0.4	-0.3	-0.3
Estonia	4.0	1.9	2.4	3.2
Romania	2.0	-3.3	0.5	-2.0
Slovakia	-6	-4	- 4	-3.5
Latvia	–	–	-4.5	-5.1
Lithuania	–	2.2	-1.7	-1.7
Bulgaria	-5.7	-11.3	-4.9	-5.2

Sources: Commission, Deutsche Bank and Government Planning Bureau of Cyprus

Despite this, all countries are well within reach of the Maastricht reference level of 3%.

- ♦ Estonia is running a continuous and substantial budget *surplus*.
- ♦ Cyprus, Poland, the Czech Republic, Slovenia, Lithuania and Romania were all below the 3% level in 1996.
- ♦ The Hungarian and Slovakian deficits were above the 3% level in 1996, but have been falling towards it.
- ♦ Only in the cases of Latvia and Bulgaria will further substantial fiscal reform probably be required in order to meet the convergence criteria.

e) Independence of the national central banks

The **Polish Central Bank** is independent from the Government in terms of the appointment procedure of the Governor. However, existing legislation does not explicitly provide the Central Bank with formal independence from the Government in the conduct of monetary policy. The formal objective of the Central Bank is the strengthening of the currency. Finally, the Law is still far from being compatible with the Treaty provision completely prohibiting Central Bank budget deficit financing. Moreover, the already loose provisions are suspended every year by the Annual Budget Law. However, the Polish authorities are currently discussing reform of the Act on the Central Bank, in order to make it compatible with the Treaty requirements.

The **Hungarian Central Bank** is formally independent from the Government - though each new Government has appointed a new Governor. Even if not formally, price stability is the Central Bank's main objective.

The **Czech National Bank** is largely independent from the Government in terms of the conduct of monetary policy and the appointment procedure of the Governor. The statutory objective of the Bank is to ensure the stability of the national currency, but this has been always interpreted in terms of price stability. The provisions concerning the possibility of the Central Bank's financing budget deficits, however, are still not in line with the Treaty requirements, though in practice the Central Bank has never done so to date. The Czech authorities are also expected to reform the Law of the Central Bank to make it compatible with the Treaty requirements.

The **Slovenian Central Bank** enjoys a relatively high degree of independence from the Government. The Governor is appointed by Parliament and the Bank is the only institution responsible for monetary policy actions. The formal objective of the Central Bank is the stability of the domestic currency and implicitly price stability. The Law on the Central Bank is not fully compatible with the Treaty prohibition of budget deficit financing, but the sound fiscal record to date has eliminated the need for this.

The **Estonian Central Bank** is largely independent from the Government. The Governor is appointed by the Council of Administration without any governmental interference. The formal objective of the Central Bank is the stability of the domestic currency and the Law prohibits budget deficit financing.

Formally, the **Romanian Central Bank** is relatively independent from the Government, both in the Governor's appointment procedure and in the conduct of monetary policy. The statutory objective of the Central Bank is the stability of the domestic currency, but this objective has not always been interpreted as price stability. The Law on the Central Bank is still not compatible with the Treaty provision which prohibits budget deficit financing. Furthermore, in the past, the Romanian Central Bank has not respected the provisions in the Law concerning the limits on the amount of financing of the budget deficit. The Government elected in November 1996 has pledged to tighten monetary policy, which implies that no more Central Bank budget deficit financing should be expected for the time being.

The **Slovak Central Bank** is largely independent from the Government in terms of the appointment procedure of its Governor and the conduct of monetary policy. The statutory objective of the Central Bank is to ensure the stability of the Slovak currency, but it has always been interpreted in terms of price stability. The provisions of the Law on the Central Bank are still far from been compatible with the Treaty, but the Slovak Republic has a sound fiscal record which has implied no budget deficit financing to date.

The independence of the **Bank of Latvia** is largely guaranteed by the Law on the Central Bank. Its formal objective is the stability of prices. The Law on the Central Bank provides for a yearly agreement between the Government and the Bank on the limits within which the latter can finance the budget deficit.

The **Lithuanian Central bank** is largely independent from the Government in terms of the appointment procedure of the Governor and the conduct of monetary policy. Its formal objective is the stability of currency. The Law on the Central Bank does not explicitly prohibit the financing of budget deficits. Lithuania has adopted a currency board since April 1994 and the conduct of monetary policy is severely limited by the amount of foreign reserves on the Central Bank balance sheet. Within the currency board arrangements there is very limited scope for discretionary monetary policy or for Central Bank deficit financing.

The **Bulgarian National Bank** is formally independent from the Government in terms of the appointment procedure of the Governor and the conduct of monetary policy. However, in the past, the Bank has been influenced by the Government in its commercial bank refinancing and budget deficit financing policies. The country has now introduced a currency board arrangement, which fixes the volume of *Leva* in circulation with reference to the National Bank's foreign exchange and gold reserves. This sets the parameters for Bulgaria's monetary policy. The formal objective of the National Bank has been the stability of the Bulgarian national currency, but with the introduction of the currency board arrangement there is no discretionary scope for the Central Bank monetary policy. Finally, the National Bank has been deeply involved in the past in financing the budget deficit, but the currency board arrangement will set a very strict limit on this activity. In June 1997, the Law on the National Bank was amended to strengthen the Bank's independence and supervisory role and to adjust its functions to the currency board arrangements.

f) Real economic performance

As well as the nominal convergence criteria, account will be taken of convergence in general economic performance. After a period of drastic contraction, all the applicants except Latvia, and perhaps Hungary, now enjoy a healthy rate of GDP growth.

Table 4: Annual percentage change of GDP in the applicant countries (1991-1995)

COUNTRY	1991	1992	1993	1994	1995
Cyprus	0.6	9.8	1.5	6.1	5.3
Poland	–	–	–	5.2	7.0
Hungary	–	-3.1	-0.6	2.9	1.5
Czech Rep.	-14.2	-6.4	-0.9	2.6	4.8
Slovenia	-8.9	-5.5	2.8	5.3	3.9
Estonia	–	–	-8.5	-1.8	4.3
Romania	-12.9	-8.8	1.5	3.9	7.1
Slovakia	-14.6	-6.5	-3.9	4.9	6.8
Latvia	-10.4	-34.9	-14.9	0.6	-1.6
Lithuania	-13.1	-34.0	-30.4	1.0	3.0
Bulgaria	–	-7.3	-1.5	1.8	2.1

Source: Commission and United Nations

However, for the ex-socialist countries, the process of transition towards a market economy has had consequences for the balances of payments. Commercial liberalization and the need to improve the standard of living caused a rapid increase in imports. The development of new industries has been too slow to produce a comparable increase in exports.

Table 5: Current account balances in the applicant countries (1990-1996)

COUNTRY	1990	1991	1992	1993	1994	1995	1996
Cyprus*	56.6	-87.5	-73.2	124.0	89.2	-17.9	-25.8
Poland	–	3067	-2146	-3104	-5788	-2590	-4245
Hungary	379	403	352	-4262	-4054	-2535	-1689
Czech Rep.	–	–	–	669.2	-49.7	-1369.1	-4476.4
Estonia	–	—	36	22	-165	-166	-443
Slovenia	–	–	926	192	540	-36	46
Romania	-3337	-1012	-1564	-1174	-428	-1639	-2336
Slovakia	–	–	–	-601	665	391	-1941
Latvia	–	–	191	417	201	-19	-495
Lithuania	–	–	–	–	-155	-205	-698
Bulgaria	–	-1710	-77	-360	-1098	-32	-26

** In millions of Cypriot £; all the others data are expressed in millios of USD.*
Source: Commission and Government Planning Bureau of Cyprus.

Unemployment[6] has also followed the transition to a market economy, though the Czech Republic, Cyprus, Hungary, Slovenia, Estonia, Romania and Lithuania all have rates below the current EU average.

Table 6: Unemployment rates in the applicant countries (1993-1996)

COUNTRY	1993	1994	1995	1996
Cyprus	2.7	2.7	2.6	2.5
Poland	14	14.4	13.3	12.4
Hungary	11.3	10.2	9.3	9.2
Czech Rep.	3.9	3.8	3.6	3.4
Slovenia	—	9	7.4	7.3
Estonia	—	—	6.6	7.6
Romania	—	—	8.1	8
Slovakia	12.2	13.3	12.8	10.9
Latvia	—	—	18.9	18.3
Lithuania	3.5	4.5	7.3	6.2

[6] According to the ILO definition, the unemployment rate indicates the percentage of persons in the total population aged 15+, who currently meet all following three conditions : (i) have no work, (ii) are actively seeking a job and (iii) are ready to take up a job within a fortnight.

Bulgaria	21.4	20.5	14.7	13.7

Source : Commission and Government Planning Bureau of Cyprus.

Conclusions

Full entry of the current applicant countries into the Euro area will depend upon a number of factors.

1. The timing of enlargement itself.

If the negotiations with the "first wave" of applicants are concluded rapidly, leading to membership of the EU in the early years of the next century, immediate membership of monetary union as well may be premature. Inflation rates, in particular, may not have sufficiently converged.

If, on the other hand, the negotiations are protracted, convergence may have progressed sufficiently to allow accession to monetary union at the same time as accession to the EU.

The same logic will apply to those applicant countries outside the first wave of negotiations.

2. Economic developments

Most applicant countries have set in train policies which will lead to fulfilment of the convergence criteria. Budgetary positions are generally satisfactory. Only Romania has a serious exchange-rate problem.

On the other hand, all kinds of unforeseen economic or political developments could derail the process. The economies of the ex-socialist countries are for the most part still fragile, with much of the financial infrastructure still new and untested. Serious political crises, with damaging economic effects, cannot yet be ruled out. Cyprus has special political and security problems.

On the other hand, it is equally impossible to predict developments within the Euro area itself. Cyclical factors could lead to a rise in inflation rates, despite the commitment of the European System of Central Banks to price stability. This, paradoxically, could make convergence by the new Member States easier.

3. "Variable geometry"

A final factor will be the resolution, in the years following 1st January 1999, of the division into Single Currency "ins" and "outs".

If those countries initially outside the monetary union for economic or political reasons soon join, there will be a strong incentive for the new Member States to do likewise.

If, on the other hand, certain Member States remain outside the Euro area for a substantial period, EMU will already have a "two tier" structure; and the new Member States would be able to join either.

Annexe: The Political and Constitutional background

a) Cyprus

Cyprus is an independent sovereign Republic with a presidential system of Government. Since the invasion of 1974, 37% of the island is under the Turkish occupation in defiance of United Nations Resolutions in favour of independence. Under the 1960 Constitution, executive power is exercised by the President of the Republic, elected by universal suffrage for a five-year term of office, through a Council of ministers appointed by him. The legislative authority in the Republic is exercised by the House of Representatives.

Cyprus warmly welcomed the Commission’s commitment to include it in the next wave of expansion. Mr Spyros Kyprianou, President of Cyprus, said that EU membership could assist in finding a solution to the protracted dispute splitting the country. On the other hand, Mr Bulent Ecevit, Turkey’s Deputy Prime Minister, warned that if the EU went ahead with planned membership talks with Cyprus, Turkey would have no choice but to unite with the northern third of the island.

b) Poland

According to the Constitution adopted by referendum in May 1997, legislative power is vested in the Parliament, composed of two chambers, the Sejm and the Senate. The President of the Republic, elected by direct universal suffrage for a five-year term, designates the Prime Minister, who forms the Government, and has the power to dissolve Parliament if it fails to approve the formation of the Government or to adopt the budget. The President also possesses a right of veto over laws voted by Parliament, although the latter can override this by a majority of three-fifths. The Government and Ministers are accountable to the Sejm.

Poland’s political institutions function properly and in conditions of stability. They respect the limits on their competences and cooperate with each other. Legislative elections in 1991, 1993 and 1997, and presidential elections in 1995, were free and fair. When they led to alternation of power, this was properly achieved. Mr Krzaklewski’s Solidarity Electoral Action, the centre-right coalition that groups together forty anti-communist small parties, won the general elections in September 1997, but it needs the support of Mr Balcerowics’ Union for Freedom to form a Government. The Opposition, now mainly represented by the Democratic Left Alliance that had been in power since 1993, plays a normal part in the operation of the institutions.

c) The Czech Republic

The Constitution adopted in December 1992, and the Charter of Fundamental Rights which forms an integral part of it, established a parliamentary democracy. Parliament is composed by two houses, the Chamber of Deputies and the Senate, the first one enjoying greater powers than the latter. The Government is answerable only to the Chamber of Deputies. The President of the Republic, elected by Parliament for a five-year term, appoints the Prime

Minister and, on the latter's proposal, the ministers. The President can also dissolve the Chamber of Deputies if the Government fails to win a vote of confidence.

The Czech Republic's political institutions function properly and in conditions of stability. They respect the limits on their competences and cooperate with each other. Legislative elections in 1992 and 1996 were free and fair. Mr Klaus's Government is sustained by the two major conservative parties of the country, the Civil Democratic Party (ODS) and the Civil Democratic Alliance (ODA). The Opposition, guided by the Social Democratic Party (CSSD), plays a normal part in the operation of the institutions.

d) Hungary

The far-reaching reform in October 1989 of the Hungarian Constitution of 1949, which gave rise to the new Constitution of December 1990, led to a smooth transition to a parliamentary democracy. Parliament is still working on the revision of the Constitution. Parliament consists of a single house, the National Assembly, which may be dissolved by the President of the Republic if it overrules the Government at least four times in a year, or it does not succeed in appointing the Prime Minister. The President of the Republic, elected by Parliament for a four-year term, has essentially a representational function. The Government is made up of a Prime Minister, designated by Parliament upon a proposal from the President of the Republic, and ministers appointed by the President upon a proposal from the Prime Minister and individually responsible to Parliament and the Government.

Hungary's political institutions function properly. Elections have been free and fair and led to alternation of power in 1990 and 1994. The Government is sustained by a coalition between the Hungarian Socialist Party (MSZP) and the Alliance of the Free Democrats (SZDSZ). The Opposition plays a normal part in the operation of the institutions.

e) Slovenia

When Slovenia declared independence in June 1991 its Parliament adopted a new Constitution which established a parliamentary democracy. Parliament is made up of a single chamber, the National Assembly. Slovenians also elect a forty-member National Council, which represents the interests of socio-economic and professional circles and those of the local authorities, and has the power to express opinions on draft legislation examined by the National Assembly or to ask for a parliamentary commission of inquiry.

The President of the Republic, elected by direct universal suffrage, may dissolve the National Assembly if it fails to designate a Prime Minister. If the President acts contrary to the Constitution or to the country's laws, the National Assembly may call on the Constitutional Court to strip him of his mandate by a two-thirds majority decision of its judges. The Prime Minister is elected by the Parliament upon a proposal from the President. Ministers are elected by Parliament upon a proposal from the Prime Minister. The Government and ministers individually are responsible to Parliament.

The Government is sustained by the Liberal Democrats. The Opposition, headed by the Social Democrats, fulfills a normal role in the operation of the institutions.

f) Estonia

Under the new Constitution adopted by referendum in June 1992, Estonia is a parliamentary democracy. Parliament, composed of one chamber, the Riigikogu, exercises the legislative power and shares the right of initiative with the President of the Republic and the Government. The President of the Republic, elected by a two-thirds majority of Parliament for a four-year term, can dissolve Parliament in three circumstances: if a Government bill is thrown out by the Riigikogu; if the latter defeats the Prime Minister or the Government; and if it fails to adopt the budget. The Prime Minister is appointed by the President but must receive Parliament's endorsement before he can form a Government. Ministers are individually accountable to Parliament.

Elections in 1992 and 1995 were free and fair, and in the latter case led to an alternation of power. The Government is sustained by the Coalition and Rural Union Party. The Opposition plays a normal part in the operation of the institutions.

There are no major problems over respect for fundamental rights in Estonia, although - according to the Commission - an acceleration of naturalisation procedures is required to enable the Russian-speaking minority to become better integrated.

g) Romania

The new Constitution adopted by referendum in December 1991 marked Romania's transition to parliamentary democracy. Parliament is composed of two houses, the Chamber of Deputies and the Senate, which exercise legislative power on a footing of strict equality. The President of the Republic, elected by universal suffrage, can dissolve Parliament if, after at least two unsuccessful attempts, no Government is formed within sixty days. The Government, which comprises a Prime Minister and ministers appointed by the President after confirmation by Parliament, is answerable to Parliament, which can overturn it by a simple majority of the two chambers sitting together.

Romania's new institutions are democratic and their stability now seems guaranteed. They do, however, need to be anchored by greater respect for the primacy of law at all levels of the apparatus of State. Elections have been free and fair - they led to a genuine change-over in November 1996. The Government is sustained by the Romanian Democratic Convention (CDR), while the Opposition is headed by the Social Democracy Party (PDSR).

Romania presents a number of shortcomings, however, with regard to respect for fundamental rights even if the measures adopted and the undertakings given by the Romanian authorities since November 1996 are steps in the right direction. For instance, much still remains to be done in rooting out corruption, improving the working of the courts and protecting individual liberties from the activities of the police and secret service. The improvements now under way since the new Government came to power suggest that Romania is on the way to meeting the political conditions laid down by the Copenhagen European Council.

Mr Victor Ciorbea, Romania's prime minister, said the EU was wrong to proceed with eastward expansion in "waves". He undertook to carry out further reforms so that the decision to deny his country early entry could be reversed.

h) Slovakia

The Constitution adopted in September 1992 established Slovakia as a parliamentary democracy. The Parliament has a single house, the National Council. The President of the Republic, elected by a three-fifths majority of Parliament, may be dismissed by the National Council with the same majority if he acts contrary to the sovereignty or territorial integrity of the country or its constitutional and democratic system. The President appoints the Prime Minister and, on his proposal, the ministers. Both the Government and the individual ministers are responsible to Parliament.

Slovakia's political situation presents a number of problems in respect of the criteria defined by the European Council in Copenhagen. The Government, sustained by the Movement for a Democratic Slovakia, does not sufficiently respect the powers devolved by the constitution to other bodies, and too often disregards the rights of the Opposition. Substantial efforts need to be made to ensure fuller independence of the judicial system, so that it can function in satisfactory conditions. The fight against corruption needs to be pursued with greater effectiveness.

i) Lithuania

In October 1992, Lithuania adopted by referendum a new Constitution, establishing a parliamentary democracy. Parliament consists of a single house, the Seimas, which can decide to hold early elections on a two-thirds majority vote. The President of the Republic, elected by direct universal suffrage for a five-years term, can dissolve Parliament if it is not able to appoint a new Government. The latter, which is accountable to the Seimas, consists of a Prime Minister and ministers individually answerable to Parliament.

Elections in 1992 and 1996 were free and fair, and permitted an alternation of power. The Government is sustained by the conservative Homeland Union. The Opposition, headed by the Democratic Labour Party and the Social Democratic Party, plays a normal role in the operation of the institutions.

j) Latvia

The old Constitution of 1922 was restored in 1993, with various amendments designed to establish parliamentary democracy. Parliament consists of a single house, the Saeima. The President of the Republic, elected by Parliament for a three-year term, is accountable to the Saeima, which has the power to dismiss him by a two-thirds majority vote. On his side, the President can put the dissolution of the Saeima to a referendum: if the referendum produces a majority vote in favour of the President's proposal, the Saeima is dissolved. If the proposal is rejected, the President is replaced. The President designates the Prime Minister, who appoints the ministers. The Government and the ministers individually are accountable to Parliament.

Elections in 1992 and 1995 were free and fair, and in each case permitted the establishment of coalition governments. The Government is sustained by the Saimnieks Democratic Party and the Voice of Latvia Party. The Opposition plays a normal part in the operation of the institutions.

As in the case of Estonia, the Commission believes that Latvia needs to take measures to accelerate naturalisation procedures so that the Russian speaking minority can become better integrated into Latvian society. It should also pursue its efforts to ensure equality of treatment for non-citizens and minorities: in particular for access to the professions.

Mr Andregs Pidegovics, a spokesman for the Latvian foreign ministry, said that some of the Commission's supporting information was already out of date, and failed to reflect the narrowing differences between Estonia and Latvia. Latvia would present fresh information before the EU summit in December 1997 about progress in reforming its economy and institutions.

k) Bulgaria

In July 1991, Bulgaria adopted a new Constitution, marking the transition to parliamentary democracy. Parliament consists of a single house, the National Assembly. The President of the Republic, elected by universal suffrage for a five-year term, may ask Parliament to reconsider a law which it has adopted, but the Assembly can override his veto by a single majority vote. The Prime Minister is appointed by Parliament, on a proposal from the President. Parliament appoints and dismisses ministers on a proposal from the Prime Minister.

Bulgaria has democratic institutions whose stability seems now secure. However, the Commission finds that they need to be reinforced by fuller respect in practice for the rule of law, at all levels of public administration. Elections have been free and fair and led to alternation of power in 1994 and 1997. The new Government is sustained by the conservative coalition of United Democratic Forces, while the Opposition is composed of the coalition of the Democratic Left, headed by the Bulgarian Socialist Party.

Bulgaria presents some gaps in respect for fundamental rights, though the Government has announced a series of positive reforms. Considerable efforts are needed to pursue the fight against corruption, to improve the operation of the judicial system and to protect individual liberties in the face of too-frequent abuses by the police and secret services. The current improvement following the arrival in power of a new government permits the conclusion that Bulgaria is on the way to satisfying the political criteria set by the Copenhagen European Council.