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Slovakia after the Introduction of the Euro (overview of the period 2009-2011)

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Abstract. The study addresses the main macroeconomic implications of introduction of the single currency in Slovakia. The main objective is to present the real impact of the introduction of the euro between 2009-2011. The study will outline the EMU criteria - budget and economic policy coordination, the common monetary policy and the single currency. These criteria should be met by countries to become the member state of the Eurozone. This is followed by the introduction of positive and negative impacts of the introduction of the single currency. We used secondary data to assess the implications of euro introduction. The introduction of the single currency had three advantages in Slovakia. The most relevant advantage was the stability – the stabile financial environment prevented the devaluation of the currency and had positive impact on the economy. The second important advantage was solving the liquidity problems the countries faced following the economic crisis. As a third benefit was the increase in competitiveness that attracted thousands of foreign investors to Slovakia. The study is focusing on the economic impacts of the introduction of the euro from the perspective of few years.

Keywords: Slovakia, EMU, Euro.

1 Introduction and Basics about the Economic and Monetary Union of the EU

The 2004 enlargement of the EU was the largest single expansion of the European Union, integrating countries with different level of economic development. Some of these countries have lagged behind in integration process and have not introduced the single currency yet. Slovakia was successful in introduction of the single currency, since the price of energy, crops and agricultural produce was low. The country experienced surprising effects of the euro introduction e.g. the export fell slightly, the unemployment increased as well as the inflation exceeded the average. The introduction of the single currency had three advantages. The most relevant advantage was the stability – the stabile financial environment prevented the devaluation of the currency and had positive impact on the economy. The second important advantage was solving the liquidity problems the countries faced following the economic crisis. As a third benefit was the increase in competitiveness that attracted thousands of foreign investors to Slovakia.

The Economic and Monetary Union (EMU) was established as an important step towards the integration of national economies. EMU involves the coordination of budgetary and economic policy, the common monetary policy and the single currency. The economic union is represented by 27 states. Some of the countries have reached a higher level of integration and introduced the single currency. These countries form the Eurozone. [5]

The decision to form an Economic and Monetary Union was taken by the European Council in the Dutch city of Maastricht in 1991 and was later enshrined in the Maastricht Treaty. It could be considered as a further step towards the economic integration. The economic integration has many benefits e.g. efficiency enjoyed by the member states individually and the EU as an economic unit as well. [8] The integration is stabilizing the economy, accelerating the growth and increases the employment. These effects have influence on the life within the union. [1,4]

We get the following conclusion about the EMU:

- harmonizing the economic policy of the member states
- harmonizing the fiscal policy of the member states by limiting the national debt and the state deficit
- independent monetary policy controlled by the European Central Bank (ECB) single currency and monetary union. [11]

The development of the economic policy within EMU is shared among the member states and the European institutions. Not only one institution is responsible for development of the economic policy. The key players in EMU are:

- The European Council – defines the general political direction and priorities of the EU
- The Council of Europe (the Council) coordinates the development of the economic policies and decides which member state can introduce the single currency
- The „Euro group“ represents the common interest of Eurozone member states
- The member states which set their national budgets in response to certain limits of deficit and debt, develop their own policies for labour, pension and capital markets
- The European Commission monitors the performance of member states and compliance with the rules
- The European Central Bank (ECB) defines the monetary policy, the main objective is the price stability

The European Parliament – together with the Council and the European Commission exercises the legislation function of the EU, exercises democratic control over the economic governance. [2, 19]

In July 1988 the European Council confirmed the objectives of implementation of the European Monetary Union (EMU). As an initiative, a committee led by Jacques Delors was established (former president of the European Commission) to study what specific stages lead to the establishment of the union and were asked to make suggestion about it. The committee consisted of the presidents of the national banks of the European Community, Niels Thygesen, professor of Economics from Denmark, Miguel Boyer, the president of Banco Exterior de España. As a result of this cooperation the Delors Report was elaborated, which proposed the establishment of the Economic and Monetary Union in three stages, each phase representing a higher level. [3]

Based on the Delors Report, the European Council determined 1July 1990 as the beginning of the 1st stage of EMU. They liberalized all the capital movements between the member states and prohibited the monetary financing of public authorities by central banks. The establishment of the European Monetary Institution (EMI) on 1 January 1994 was the beginning of the second phase of the EMU. At the same time, the Presidential Committee ceased to exist. The temporary existence of EMI reflected the state of monetary integration of the Community. The EMI had no responsibility to determine and implement the monetary policy of the EU, this remained the responsibility of the national authorities and was not empowered to implement foreign exchange interventions. The members of the European Council reached a consensus in December 1995 that the European currency planned to be introduced on 1 January 1999 will be the „euro". They have also determined the transition steps to the single currency.

The third and the final phase of EMU started on 1 January 1999 by fixing the currency rates of the participating 11 member states and introduction of the single monetary policy under the supervision of the ECB. By 1 January, the number of participating member states increased to 12 by the accession of Greece to the EMU. On 1 January 2007, Slovenia became the 13th member of the zone, a year later followed by Cyprus and Malta. Slovakia joined in 2009, Estonia on 1 January 2011. The central banks of these countries automatically became the members of the euro system. [7]

2 The Slovak Experience – 2 Years Following the Introduction of the Single Currency

The introduction of the euro was quite easy, because the price of energy and agricultural produce was low. Slovakia also experienced surprising effects of the new currency e.g. the volume of export declined, the unemployment rate increased, and the inflation was higher than the average.

The Central Bank of Slovakia (NBS) and the Financial Ministry are forecasting 3,5% increase in consumer price, which in contrary to declining trend is still 75% higher than the 2% Eurozone average determined by the European Central Bank (ECB). [20]

Slovakia is a small economy, but this small economy contributes to increase of the EU average (Euro-16 countries). According to the ECB, this area is weakening the stability of the Eurozone. This can be explained by the trend in the Eastern European countries. [9]

2.1 Positive Effects of the Introduction of the Euro

By joining the Eurozone, Slovakia has strengthened its position in workplace creation, long-term potential for economic growth and can control the inflation. Slovakia has become a strong symbol of economic and political progress as well as the integration process.

The introduction of the new currency had three benefits for the country. The most important of these is the existence of stability. They have managed to create a stable financial environment to avoid the depreciation of their currency. The second important step was to find solution for the liquidity problems most of the countries faced due to the economic crisis. The third important benefit was the increase of competitiveness that attracted thousands of investors to Slovakia. [12, 20]

Further positive impact was the abolition of transaction costs and the exchange rate risk. Joining the Eurozone resulted in low base rate and increasing price competition. The flexibility of the labour market has increased since 2004. The number of people working abroad can be estimated approx. 200.000. About 60% of them work in the EU country which is not a member of the Eurozone (about 90.000 people work in Hungary or Czech Republic). An improved transparency will be characteristic for the accession of these countries. [6]

2.2 Negative Impacts

The most important cost of the introduction of the euro is the partial loss of the seigniorage income as the Slovak National Bank has lost its responsibility to issue cash. The national bank loses its independence to determine the exchange rate and interest rate policy. These duties will be exercised by the European Central Bank and the consequences of decisions in which Slovakia is also involved will have an impact on the economy of the Eurozone. The possible worldwide economic shocks can be avoided by the flexible change in price and wage levels.

Following the introduction of the single currency, Slovakia and the corporate sector will face one-time expenses. The costs associated with the introduction of the single currency include the issue and distribution of coins and banknotes, collecting the old coins and banknotes, administration costs, providing information for the public, financing trainings, introducing IT support systems to ensure dual pricing and increased consumer protection. Based on the study of the Slovak National Bank this amount accounts for 0.3% of the Slovak GDP.

The inflation surplus is negative for the Slovak economy in case of consumer or budget overspending or increasing wage outflow. The accession to the EMU resulted in increasing wage outflow into the neighbouring Non-eurozone countries due to lower price level. Hungary and Poland became the favourite destinations of shopping tourism. The danger of shopping tourism is that before the introduction of the single currency, domestic consumption was the main catalyst of the economic growth in Slovakia, while the wage outflow and the decreasing domestic demand deteriorated the growth prospects of the economy. [10, 15]

2.3 The Real Impact of the Introduction of the Euro

The impact of the introduction of the euro on the Slovak economy was more favorable than the market analysts forecasted. Before introduction of the single currency the analysts forecasted 7.9% GDP deterioration from 2008 to 2009. In spite of the negative forecasts the values detected were positive as you can see on Table 1 based on own editing of dates by Slovak Statistical Office and Slovak National Bank [13, 20, 18].

Table 1. Basic macroeconomic indicators of Slovakia, 2009-2011.

		2009	2010	2011
GDP (current prices)	Bill. EUR	62.8	65.7	69.1
GDP growth (real)	%	-4.9	4.2	3.3
GDP per capita (at current prices)	EUR/capita	11 640	12 140	12 700
Inflation (consumer price index)	%	1.6	1.0	3.9
Rate of unemployment	%	12.0	14.4	13.5
Budget balance	% of GDP	-8.0	-7.7	-4.6
Government debt (at the end of the year)	% of GDP	35.5	41.1	43.3
Balance of current account	% of GDP	-2.5	-2.4	0.06

The structure of the Slovak economy has not changed significantly, which means that the industry has ensured the biggest added value of 32%. The unemployment fell by 0.9% to 13.5% in 2011. This was a positive change since more and more individuals are behind the produced value. The inflation has increased rapidly following the 1% increase in 2010. It reached 3.9% in 2011. The increase of average wage did not follow the price increase, which has increased by 2.2% to 786 EUR. It means 1.6% net increase of real wages.

After the introduction of the euro, the EU funding has increased considerably. 25. 02% of the funding was utilized in worth of 11.5 billion euros. Being a member of the Eurozone opened the markets for the Slovak companies that resulted in 17.3% increase of exports to the EU countries and 18% increase of export activities to the OECD members. The export of agricultural produce increased the most (31. 3%). (For background information see Table 2 about dates by Slovak National Bank [13]).

Table 2. Foreign trade turnover of Slovakia, 2008-2011

		2008	2009	2010	2011
Transaction balance	Bill. EUR	-0.7	0.3	0.5	2.4
Export	Bill. EUR	47.7	40.2	48.3	56.4
Import	Bill. EUR	48.4	39.9	47.8	54.0
Balance of services	Bill. EUR	-0.5	-1.1	-0.7	-0.3
Export	Bill. EUR	5.8	4.3	4.4	48
Import	Bill. EUR	6.3	5.4	5.1	5.1

The development of the Slovak economy depends on the growth of import investments. The capital influx can help the development of the economy. The Slovak conditions became favourable for the foreign investors in 2011. It can be explained by the disappearance of exchange rate costs and the increase of real wages. [18]

Stoličná – Chorvatovičová –Kočišová analyse the effect and scope which Euro adoption have on level of foreign direct investment in Slovakia. The results of this research with the dates from Slovak National Bank you can see in Table 3. [17]

Table 3. Import and export of direct capital investment in Slovakia, 2009-2011

		2009	2010	2011
Foreign direct investment – import	Bill. EUR	-4.376	-0.107	0.846
Foreign direct investment	Bill. EUR	36.469	37.632	n.a.
Capital investment in another country	Bill. EUR	0.651	0.404	0.053
Capital investment stock	Bill. EUR	2.188	2.494	n.a.

The biggest investors from Slovakia during the mentioned period was Matador in fields of vehicle industry, Slovenský investičný holding (Slovak Investment Holding) focused on property development, Holcim Slovensko in fields of cement, gravel and concrete production, J&T on property development and Penta focused on venture capital/food industry.

3 Conclusion

The development of the Slovak economy during the period 2004-2008 was intense. The reform packages made the economy characterized by high potential more transparent and attractive for foreign investors. The influx of foreign investment resulted in economic development and record growth was detected in 2006 and 2007. The disadvantage is that the regional and social disparities have not diminished due to enormous economic growth.

The growth in the past few years has stabilized the economy. The economic policy was able to cope with the increasing unemployment, budget deficit and national debt without introducing serious restrictions. The development of regions inhabited by Hungarians is determined by new opportunities due to the accession to the EU and the Schengen area.

The currencies of the neighbouring countries were devalued as a result of the economic crisis. The regions of Southern Slovakia got into controversial situation with the regions beyond the country border that seemed to label off with the increased shopping tourism until the strengthening of the Hungarian currency. The introduction of the single currency results in benefits and real economic costs both in short and long term.

Slovakia might be an example for Hungary and the neighbouring member states, what kind of tasks are necessary to master before introduction of the euro. The introduction of the flat-rate tax system in Slovakia contributed to acceleration of capital inflow and economic development. The private and pension funds prove to be strong, but the new government is planning radical restructuring of these institutions, which might have a negative impact on pension funds. The new government forecasted serious changes in healthcare, public administration and education. There was no other solution, because the overspending of Fico government has visible negative effects. The introduction of the single currency has practically gone smoothly. Slovakia has joined the Eurozone as early as possible, which promises shelter during the economic crisis and can minimize the risk of exchange-rate speculations.

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