The Path to Euro Adoption: a Case Study of Slovenia and Slovakia[1]

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Abstract: By the terms of their treaties of accession, the financial integration and the adoption of the euro became binding on all new Member States of the European Union. Once they meet the convergence criteria and ensure their laws are compatible with the euro area, they are legally obliged to adopt the euro. This paper aims to track the integration path into the euro area of Slovenia and Slovakia, and to find out the main lessons from these stories. The results revealed that the process of adopting the euro in both countries has been very smooth and rapid, due to a general political and public consensus driven by an efficient communication strategy. Thanks to the emphasis on macroeconomic stability throughout the pre-accession period and due to clear economic policy priorities, Slovenia managed to remedy the economic imbalances and to meet the nominal convergence criteria. In the same time, fundamental institutional reforms and foreign direct investment have allowed Slovakia to adopt an export-oriented growth model that made this country one of the most notable examples of the catching-up process in recent decades.

Key-Words: Euro adoption, Slovenia, Slovakia, big-bang scenario, dual circulation, nominal convergence, real convergence
JEL Classification: E30, E58, E61, F15

1 Introduction

Slovenia and Slovakia took part in the largest expansion of the European Union (EU) in May 2004. They have managed to adopt the euro in a quite short period after the EU accession, being considered two successful stories due to their smooth and rapid transition.

The Republic of Slovenia was very determined to join the euro area. Between 2004 and 2006, the Slovenian authorities focused all their economic policies on meeting the Maastricht criteria while setting a target date for the adoption of the single currency. The efforts of the Slovenian authorities have been successful, so that it became the first of the ten new EU countries to adopt the single currency. The steady pace of economic growth and the lack of major macroeconomic imbalances during the transition period have allowed Slovenia to easily meet the accession criteria. The speed and the success of adopting the euro by Slovenia has been associated with a general consensus between political parties, public opinion and the social partners, but also with a gradual transition model to a market economy, the emphasis on macroeconomic stability throughout the pre-accession period and clear economic policy priorities (Lavrač, 2010). Moreover, an appropriate communication strategy gave to Slovenian citizens the opportunity to better understand the benefits of joining the euro area. In this context, Slovenia has been mentioned by the European authorities as a successful example in the adoption of the euro (European Commission, 2013a).

The Slovak Republic became part of the euro area five years after joining the EU. This economy is considered one of the most notable examples of the catching up process in recent decades (European Commission, 2009a). Performance has been made possible by a consistent economic policy and, in particular, by the implementation of economic reforms, investor-friendly legislation and effective measures to adopt the euro. Access to the single market and the adoption of the acquis have significantly contributed to the success of

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Slovakia. On the one hand, the elimination of trade barriers and the application of European standards have significantly reduced business costs, encouraging trade and the country's participation in European value chains (Blind et al. 2018). On the other hand, a stable and predictable regulatory environment has increased the level of investment security, helping to increase the flow of foreign investment and providing Slovakia with the necessary resources to ensure a high level of competitiveness. Fundamental institutional reforms and foreign direct investment have allowed Slovakia to move to a functioning market economy and to adopt an export-oriented growth model, supporting nominal and real convergence with the euro area.

The trajectory of euro adoption was quite similar in these two countries. In both cases the authorities concluded that the benefits of joining the euro area outweigh the costs and that their negative effect was to be mitigated by appropriate economic policies.

2 Institutional arrangements of euro adoption

The Slovenian authorities have carried out an active and thorough preparation of the entire euro area accession process, which has taken place in several steps (Table 1). The first step towards the euro was taken before becoming an EU member, by defining its National Strategy for Adoption of the Euro in November 2003. In the same year, the Bank of Slovenia and the government developed the Program for accession to the European Exchange Rate Mechanism II (ERM-II) and adoption of the euro, which was the cornerstone of the whole process. This Program included a detailed plan for Slovenia’s accession to the ERM-II as soon as possible, setting the target date for the adoption of the euro in January 2007. According to the program, the priority of all economic policies became meeting the convergence criteria. The second step that brought Slovenia closer to the euro area was a rapid entry into the ERM-II in June 2004. The EU Council set an irrevocable exchange rate between the Slovenian tolar and the euro of 239.640, corresponding to the official exchange rate on Slovenia’s accession to the exchange rate mechanism. Slovenia’s participation in ERM-II was surprisingly smooth, so that for two years the market exchange rate remained extremely close to the official exchange rate and there were no tensions in the foreign exchange market. Lavrač (2010) argues that Slovenia’s successful experience in ERM-II was the result of a combination of wisdom and luck, the right choice of macroeconomic policy measures and favourable internal and external circumstances. In 2005, was made the third step, the Slovenian government and the Bank of Slovenia drew up the Euro Transition Plan, which detailed the steps for a smooth transition to the euro. To this end, the Coordinating Committee for Technical Preparations of Euro Changeover has been set up, coordinated by the Ministry of Finance and the Bank of Slovenia. Also in 2005, the Bank of Slovenia and the Slovenian government adopted the Communication Strategy on the introduction of the euro for the period 2005-2007, on the basis of which a broad information campaign was launched under the slogan “Euro for all of us”. Within the communication program, in 2006, a special website was created, which presented to the general public details of the entire process of conversion to the euro (http://www.evro.si). This strategy and the support of the project through a social pact proved to be important elements of the Slovenian success in euro adoption (Lavrač, 2010). According to the Eurobarometer opinion poll (European Commission, 2006), the support for the euro adoption by Slovenians has consistently been among the highest of all ten new Member States, exceeding 60% in 2006. In 2006, Slovenia managed to meet both nominal and legislative convergence conditions. Thanks to effective macroeconomic stabilization policies, it managed to remedy the economic imbalances and maintain a remarkably resilient economy.

Similar to Slovenia, the Slovak authorities expressed their official intention to join the euro area through the Strategy for adoption of the euro developed in July 2003. The basic argument for euro adoption was that Slovakia could reap the full benefits of European integration only if it joined the euro area. After a detailed analysis of the nominal and real convergence of the Slovak economy with the EU, the authorities concluded that Slovakia could join the ERM-II in 2005 and join the euro area between 2008-2010 (NBS, 2003). In addition, the authorities noted that a credible strategy for adopting the single currency will send a strong positive signal to foreign investors, accelerating economic restructuring. Only six months after EU integration in September 2004, the National Bank of Slovakia and the Ministry of Finance drew up the Specification of the strategy for adopting the euro, which included: (1) the assessment of the Slovak economy’s ability to join the euro area (2) the stages of the transition to the euro and (3) the direction of economic policies that should support overall economic and financial stability in the pre-euro area period, in particular in the ERM-II, but also post-accession period (NBS, 2004). This time, in view of the prospects for meeting the Maastricht criteria, the authorities have set an exact date for the adoption of the single currency, 1 January 2009. In November 2005, Slovakia joined ERM-II and initiated a comprehensive and thorough preparation process for accession to the euro area. The central parity of the crown was set at 38.4550 crowns for one euro at the time of accession to ERM-II, being revalued starting from March 2007, at the rate of 35.4424. In 2007, the Ministry of Finance, in collaboration with the National Bank, the Ministry of Economy and the Ministry of Justice, developed the National Euro Changeover Plan (NBS, 2007a). In this context, the Government appointed the Ministry of Finance as the National Coordinator for the process of introducing the euro and set up the National Coordination Committee for the euro changeover.

Table 1: The main institutional arrangements of the euro adoption in Slovenia and Slovakia

Main steps	Slovenia	Slovakia
Formal commitment	**November 2003** National strategy for adoption of the euro Program for accession to the ERM-II Target date for adoption of the euro - January 2007	**July 2003** Strategy for the adoption of the euro Target date for joining the ERM-II - 2005 Target period for the euro adoption – between 2008-2010 **September 2004** Specification of the strategy for adopting the euro Target date for the euro adoption - January 2009
Entry into the ERM-II	**June 2004** The European Council set an irrevocable exchange rate between the Slovenian tolar and the euro of 239.640	**November 2005** The central parity was set at 38.4550 crowns for one euro at the time of accession to ERM-II, being revalued starting from March 2007, at the rate of 35.4424
Changeover Plan	**2005** Plan for euro adoption Coordinating committee for technical preparations to introduce the euro	**2007** National euro changeover plan National coordination committee for the euro changeover Plenipotentiary of the Government for the introduction of the euro (during the ERM-II).
Communication campaign	**2005** Communication strategy on the introduction of the euro for the period 2005-2007 Dedicated website - http://www.evro.si	**2007** Communication strategy on the euro introduction Working committee on communication Dedicated website - www.euromena.sk
Fulfilment of convergence criteria	**2006** Fulfilment of all convergence criteria and the full legal compatibility European Council decision allowed Slovenia to join the euro area from 1 January 2007	**2008** Fulfilment of all convergence criteria and full legal compatibility European Council gave its green light to the adoption of the euro by Slovakia on 1 January 2009

Source: Author’s adaptation based on the studied literature.

In order to inform as many citizens as possible in a timely manner about the process of switching to the euro, the Slovak authorities developed the Communication Strategy on the Euro Introduction in 2007 (NBS, 2007b). In addition, under the leadership of the National Bank, was set up the Working Committee on Communication. Individual communication activities were carried out by the National Bank, the Ministry of Finance, the government and other public administration institutions. The communication campaign was very active, through television and radio, a dedicated website (www.euromena.sk) and a hotline for information on the euro, conferences and seminars, but also through the distribution of millions of copies of publications and materials. In addition, citizens received information directly by email related to the changeover to the euro and the

conversion tools (European Commission, 2013b). As a result of this campaign, 54% of Slovaks surveyed were in favour of adopting the euro in 2006 (European Commission, 2006).
Slovakia has managed to successfully meet all nominal convergence criteria at the time of the adoption of the euro. It became one of the European economies with the highest GDP growth rate per capita during the 2000-2008 period. In addition, it accounted for the largest foreign direct investment inflows as a share of GDP in the region. Havlat et al. (2018) argues that foreign direct investment was one of the main factors of economic growth in Slovakia in the pre-accession period, as they were channelled mainly in export-oriented sectors.

3 Preparation stages of the euro changeover process

The euro changeover process has started with a thorough preparation by the Slovenian and Slovak authorities well in advance the target date. Both countries have established dual display of prices rules, developed Price Codes and adopted the Big-Bang scenario, i.e. the euro was introduced simultaneously in cash and scriptural form without a transitional period. The compliance with rules was carefully monitored by the authorities in both cases (Table 2).

Table 2: The main stages of the euro changeover in Slovenia and Slovakia

Stage 1	Stage 2	Stage 3	Stage 4
Dual display of prices	**Monitoring the prices**	**The Big-Bang scenario**	**The dual circulation**
Slovenia - nine months before accession and six months after the introduction of the euro.	Slovenia - the Bureau of Statistics, the Ministry of Economy and the Association for Consumer Protection have signed an agreement to monitor the prices. The Chamber of Commerce and Industry was involved in the price surveillance process, and required Slovenian companies to adhere to a Price Code.	Slovenia - the euro entered circulation on 1 January 2007.	Slovenia - only two weeks. The tolar could be exchanged free of charge at commercial banks until March 2007, while the Bank of Slovenia continued to do so until the end of 2016.
Slovakia - five months before accession and lasted until December 2009.	Slovakia - the Slovak Trade Inspectorate carefully monitored the prices. The price monitoring scheme run by the Slovak Consumers' Association. The Price Code of Ethics, by which the signatories undertook to convert prices accurately, without exploiting the situation.	Slovakia - the euro entered circulation on 1 January 2009.	Slovakia - only two weeks. The banknotes could be exchanged free of charge at commercial banks until the end of 2009 and at the Bank of Slovakia indefinitely.

Source: Author's adaptation based on the studied literature.

In order to avoid unjustified price increases when switching to the euro, the Slovenian authorities have decided that the prices of all goods and services must be displayed in both tolar and euro (dual display of prices), nine months before accession and that this process should continue for six months after the introduction of the euro. In addition, in order to closely monitor the evolution of prices before and after the euro adoption, the Bureau of Statistics, the Ministry of Economy and the Association for Consumer Protection have signed an agreement on how to monitor the prices. To this end, the Statistical Office undertook to present in its monthly reports the list of goods and services which had justified and specific price increases. The Chamber of Commerce and Industry was also involved in the price surveillance process, which required Slovenian companies to adhere to a Price Code, by which they undertook not to increase prices in the process of introducing the single currency. The euro entered circulation on the same day that it officially became the country's new currency, on 1 January 2007.

The dual circulation period was very short, only two weeks, during which the population was able to make payments using the Slovenian tolar and euro. Slovenians had the opportunity to exchange the tolar free of charge at commercial banks until March 2007, while the Bank of Slovenia continued to do so until the end of 2016. All amounts deposited with banks, including money in current accounts, were automatically converted into euro on 1 January 2007. As a result, the transition to the euro in Slovenia has taken place successfully. The opinion poll reflected the positive public perception of the changeover to the euro in Slovenia. According to Eurobarometer data, 95% of Slovenes surveyed considered the introduction of the single currency to be smooth and efficient and 56% considered price conversions to be correct (European Commission, 2007).

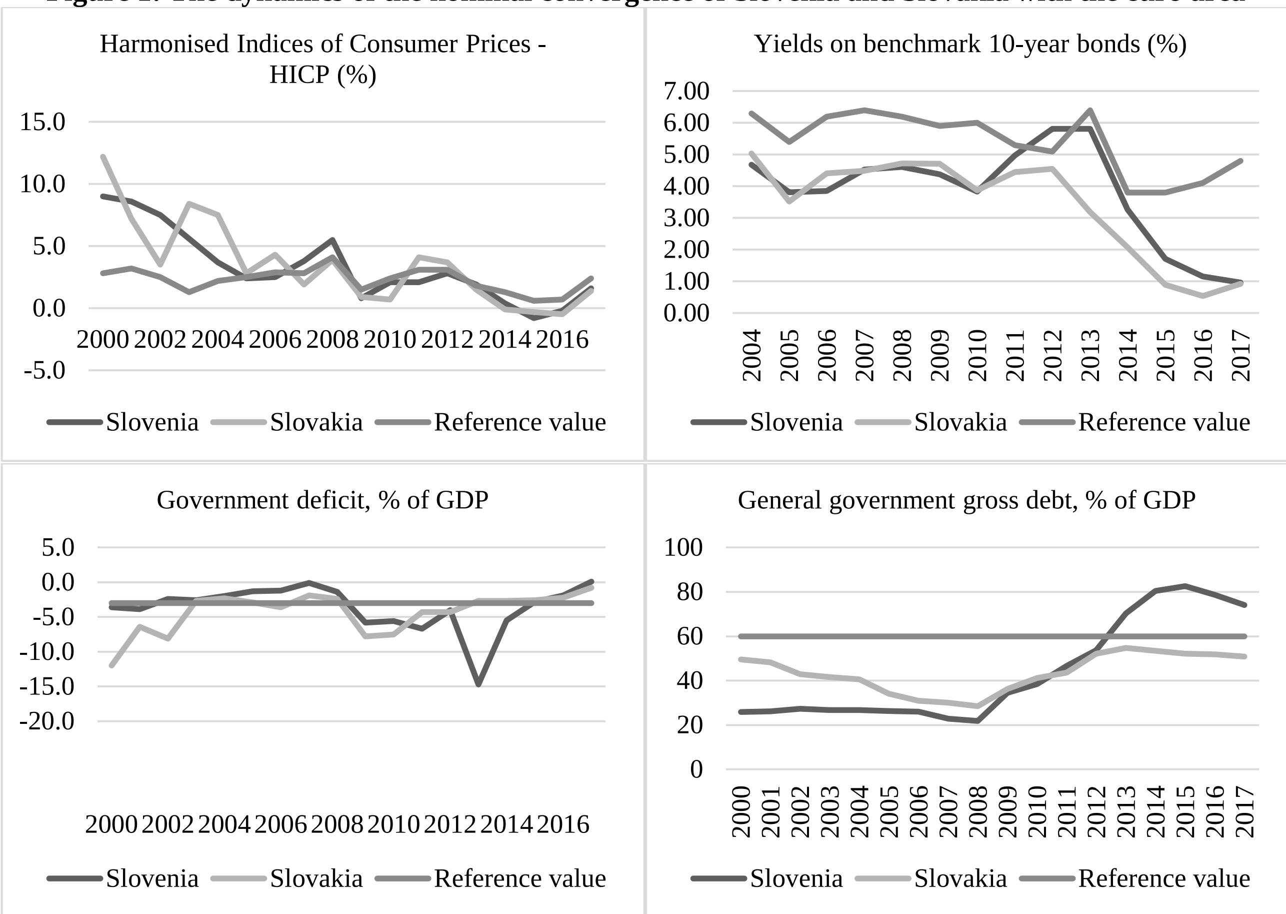
In the same vein of avoiding unjustified price increases with the changeover to the euro, the Slovak authorities have initiated a series of strategic actions. Firstly, the double display of prices became mandatory five months before accession and lasted until December 2009. The compliance of shops and service providers with this rule was carefully monitored by the Slovak Trade Inspectorate, which visited more than 15,000 economic units throughout this period. As a result, the share of commercial units that displayed prices accordingly increased from 54% to 85% between August and November 2008 (European Commission, 2013b). Secondly, these actions were complemented by the price monitoring scheme run by the Slovak Consumers' Association. Thirdly, citizens were encouraged to report any suspicious price increases to the price monitoring institutions or to the Government Plenipotentiary. Throughout that period, all the complaints were fully investigated. Fourthly, Slovakia has implemented the Price Code of Ethics, by which the signatories undertook to convert prices accurately, without exploiting the situation. Approximately 16,000 stores, service providers and local and regional administrative offices have signed this code. Unlike other countries that have joined the euro area, Slovaks have had the lowest level of concern about possible price increases following the adoption of the euro (European Commission, 2009a). According to the Eurobarometer opinion poll, almost all Slovaks felt well informed about the changeover to the euro and a large part felt very happy to adopt the euro as their national currency. As a result, inflationary pressures related to the changeover have been limited and have not led to significant price increases since the introduction of the euro. Moreover, most companies in Slovakia have started preparing for the changeover to the euro well in advance. According to the July 2008 opinion poll (European Commission, 2008), around 80% of businesses started the preparations more than 6 months before the introduction of the single currency. At the same time, public administration institutions have prepared all the necessary legislation for the changeover to the euro, trained staff (especially those in direct contact with the public) and arranged for IT systems to be compatible with the euro. The euro entered circulation on 1 January 2009. As in the case of Slovenia, the dual circulation period lasted only two weeks. At the same time, the banknotes could be exchanged free of charge at commercial banks until the end of 2009 and at the NBS indefinitely. For a faster withdrawal of the national currency, commercial banks have been supplied with euro since September 2008, and over 6,500 companies have been replenished in December 2008. A few months earlier, banks had encouraged the public to deposit excess cash in their bank accounts and use payment cards to reduce the amount of cash to be exchanged after 1 January. In addition, some banks offered citizens the opportunity to exchange the Slovak koruna for free at the official conversion rate in the last weeks of 2008. All these actions determined 91% of Slovaks surveyed in 2009 to believe that the introduction of the single currency was smooth and efficient (European Commission, 2009b).

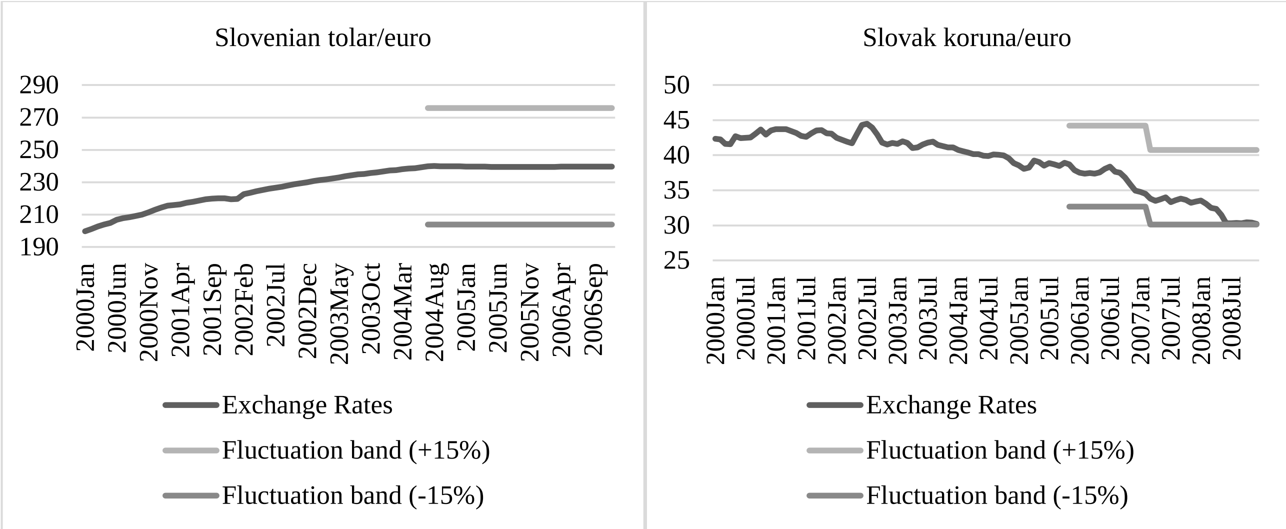
4 The dynamics of nominal and real convergence with the euro area

The steady pace of economic growth and the lack of major macroeconomic imbalances during the transition period have allowed Slovenia to easily meet the accession criteria. Due to coordinated and consistent action of monetary and fiscal policy in that period, the country has recorded a marked decrease in the inflation rate, from a level of 9% in 2000 to only 2.9% in 2006. Thus, the criterion of price stability met the reference established by the Maastricht Treaty in the pre-accession period (Figure 1). The sustainability of public finances has been ensured since 2002 until the euro adoption. It is worth noting about the countercyclical fiscal policy which has reduced constantly the budget deficit since 2004, from 2% to 1.2% in 2006. The public debt as a share of GDP was well below the reference value during the whole period of accession. Long-term interest rates in Slovenia have consistently shifted towards the average yield on euro area bonds. This development reflects investors' confidence in the monetary policy promoted by the central bank and the general economic and fiscal developments in Slovenia. Slovenia's current account surplus, recorded during the transition period, led to the appreciation of the national currency. In this context, the central bank established the managed floating exchange rate regime and promoted a foreign exchange policy aimed at depreciating the nominal exchange rate in the period 2000-2004. In 2004, Slovenia joined the ERM-II, managing to maintain a volatility of the tolar against the euro well below the fluctuation margin of less than 0.1%.

In the case of Slovakia, fundamental institutional reforms and foreign direct investment have allowed it to move to a functioning market economy and adopt an export-oriented growth model, supporting nominal and real convergence with the euro area. In 2004, Slovakia joined the EU with an inflation rate of 8.5%, reaching ERM-II in 2005 with a rate of only 2.8% (Figure 1). Following the Maastricht criteria, Slovakia recorded an inflation rate of 3.8% in 2008, in line with the benchmark. The early 2000s were characterized by a budget deficit of about 13%, caused by the economic recession of that period. The situation of public finances has improved markedly in the coming years. However, in 2004, Slovakia was subject to the excessive deficit procedure by the European Commission, which lasted until 2008, when it finally met the Maastricht criterion. The public debt as a share of GDP was maintained at around 50% throughout the whole period. The evolution of the long-term interest rate reflects investors' confidence in the policies promoted by the Slovak authorities, it is well below the reference value. The Slovak koruna's exchange rate against the euro has shown a steady trend of appreciation, driven by the high pace of economic growth. In view of the appreciation trend of the koruna, at the request of Slovakia, the central parity of the koruna against the euro in ERM-II has been revalued since March 2007, from 38.4550 to 35.4424.

Figure 1: The dynamics of the nominal convergence of Slovenia and Slovakia with the euro area

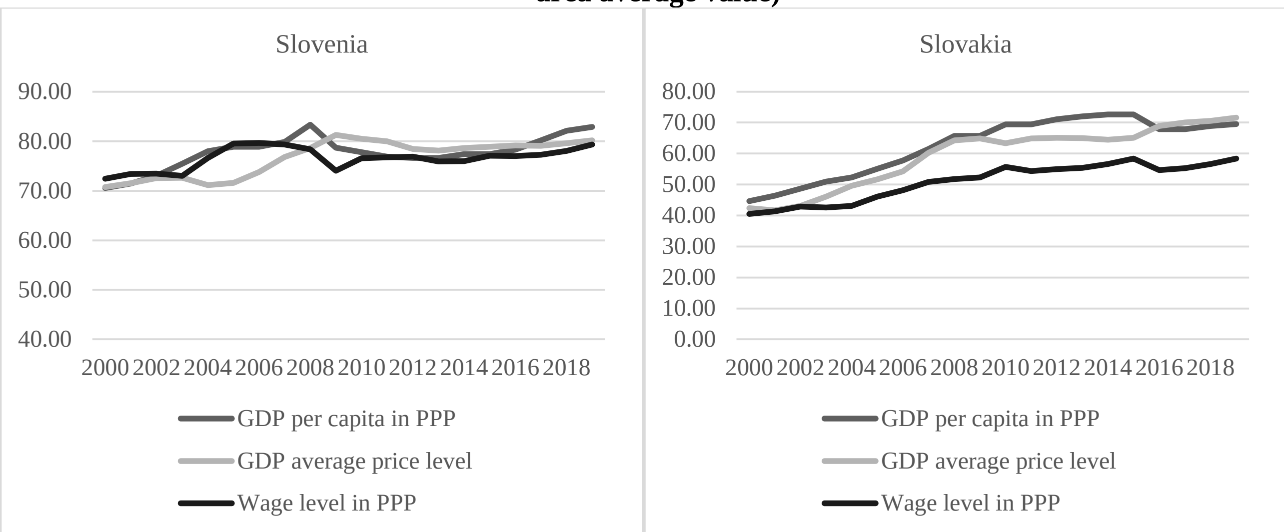




Source: Author's elaboration based on Eurostat (2020).

Slovenia has joined the EU with a particularly high convergence of GDP per capita and prices, of 78% and 71%, respectively, of the euro area average. It reached even higher convergence of GDP per capita and prices when it joined the euro area in 2007. Purchasing power parity (PPP) wages reached 79% of the euro area average in 2007, remaining at the same level to date (Figure 2). In the same time, Slovakia recorded a high rate of GDP growth per capita in the 2004-2008 period, being considered one of the most notable examples of the catching up process in recent decades. This country has joined the EU with a GDP per capita relative to the euro area of only 53% and with a price level of 46%. It reached a level of GDP per capita and prices convergence of 66% and 64% upon accession to euro area. The PPP wages have recorded a positive trend also.

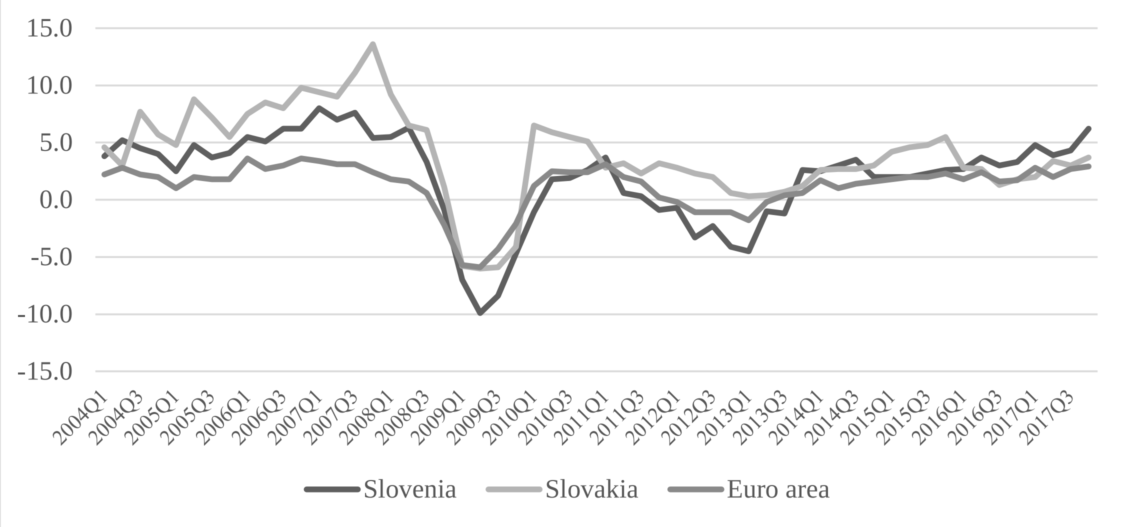
Figure 2: The dynamics of the real convergence of Slovenia and Slovakia with the euro area (% of euro area average value)



Source: Author's elaboration based on Eurostat (2020).

Another key element that reflects the economic convergence of Slovenia and Slovakia with the euro area is the degree of their economic cycles' synchronization. Both countries have quite a high degree of synchronization with the euro area (Figure 3). It can also be noticed that both the Slovenian and the Slovak economies have grown more sharply compared to the euro area in positive cycles. This development allowed them to close the gap on convergence with the euro area.

Figure 3: Economic cycle synchronization (GDP annual growth rate, %)



Source: Author's elaboration based on Eurostat (2020).

4 Conclusion

The paper aimed to analyse the integration path into the euro area of Slovenia and Slovakia, and to draw out the main conclusions from these two stories. Our results have shown that the process of adopting the euro in both countries has been very smooth and rapid, due to a general political and public consensus and an efficient communication strategy. In both cases the determination of the authorities to adopt the single currency was argued by the benefits of joining the euro area which outweigh the costs.

The trajectory of euro adoption was quite similar in Slovenia and Slovakia. The euro changeover process started with a thorough preparation by the Slovenian and Slovak authorities well in advance the target date. Both countries have established dual display of prices rules, developed Price Codes and adopted the Big-Bang scenario, i.e. the euro was introduced simultaneously in cash and scriptural form without a transitional period. The compliance with the rules was carefully monitored by the authorities in both cases. All these actions helped to avoid unjustified price increases when switching to the euro and created the positive public perception of the changeover in both countries.

Furthermore, upon the accession to the euro area, both Slovenia and Slovakia managed to meet nominal and legislative convergence conditions. Thanks to a gradual transition model to a market economy, the emphasis on macroeconomic stability throughout the pre-accession period and clear economic policy priorities, Slovenia managed to remedy the economic imbalances and to maintain a remarkably resilient economy. Moreover, it reached a high convergence of GDP per capita and prices when it joined the euro area in 2007. In case of Slovakia, fundamental institutional reforms and foreign direct investment have allowed it to move to a functioning market economy and adopt an export-oriented growth model, supporting the catching up process and assuring nominal and real convergence with the euro area.

These two stories have shown that integration to the euro area should be a political decision, which must enjoy the widest democratic support of the citizens. Moreover, careful and pro-active preparation of the euro adoption pays off. All the preparations should have to start at a very early stage. The introduction of euro notes and coins needs to be swift and carefully prepared. The same applies to the period of dual circulation, which should preferably be short. A series of measures should be taken to avoid any impact on prices. An important element is the mental changeover that takes considerably more time than the physical one. This is why a communication strategy is of major importance for a smooth transition. Simply meeting nominal criteria is far from enough for a country to benefit from adopting the euro, real sustainable convergence is a key precondition.

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