

## SLOVAKIA'S PREPARATION FOR THE EURO

Joaquín Almunia, Commissioner of the European Commission

*On 10 March 2005 the University of Economics in Bratislava, both the academic community and students, welcomed a distinguished guest – Joaquín Almunia, member of the European Commission responsible for economic and financial affairs. At the university he gave a lecture, focusing on the adoption of the euro in Slovakia. In the introduction to his presentation, J. Almunia thanked those present for this opportunity to speak to the academic public on the future entry of the SR to the euro-area and informed those present of his plan to visit each of the new EU member states and in this way learn of their preparations for implementing the euro.*

*He emphasised that timely preparation is of the essence not only for the countries wishing to enter the euro-area early, but also for those planning a longer pre-accession period. He considers sufficient advance and sound preparation very important.*

*He assessed positively the reforms Slovakia has made in recent years. He mentioned that consolidation of public finance together with structural reforms should contribute to the better functioning of the economy and thus create the preconditions for sustainable growth. As he said later, the European Commission adopted as its main priority the Lisbon Agenda of structural reforms, therefore attention in the coming years will have to be focused on the deficit in the realisation of tasks, something which in J. Almunia's opinion is the main cause of the unsatisfactory progress achieved in the 5 years of the Lisbon Strategy. "If we want to succeed, the member states must do their bit", he said.*

### The lecture unabridged

I am particularly glad to be in Slovakia today and to have the opportunity to speak about your country's future entry into the euro area. I have scheduled visits to each of the ten newly acceded Member States in order to get a better understanding of the various ongoing preparations for the adoption of the euro. Timely preparations are extremely important not only for the countries which are planning to join the euro area at an early stage, but also for those which foresee a longer period before entry. Careful preparations are extremely important and Slovakia will be rewarded by starting well in advance to get ready for the euro adoption.

Let me first of all congratulate you on the impressive reforms implemented over the recent years and I very much encourage you to continue in this direction. The consolidation of public finances combined with structural reforms should contribute to a better functioning of the economy, thereby creating preconditions for sustainable growth.



Joaquín Almunia, Photo: Z. Jójárt

Nevertheless, there is no time for complacency and many challenges remain. As you surely know, the Commission has set the Lisbon agenda of structural reforms as its key priority. In the coming years, we need to address the implementation gap which has been the major cause for the disappointing progress achieved in the first 5 years of the Lisbon strategy. It is clear that Mem-

ber States have to take up their share of the work if we want to succeed.

Slovakia has been a frontrunner in implementing reforms and thus sets an example for other Member States. I was pleased to note that the government has recently adopted its National Lisbon Strategy, a document setting out structural reform priorities for increasing Slovakia's competitiveness. I would urge Slovakia to proceed in its reform drive and implement the measures notably foreseen in areas such as human resources, research and development and information technologies. These reforms will contribute to create a stable and flexible economic framework, thereby lay-



ing the basis for Slovakia's successful membership in the euro area.

Today I would like to focus my speech on three main issues:

- First of all, I would like to refer in greater detail to the macroeconomic achievements of the Slovak economy and to the challenges ahead.

- Second, I will point out the need for timely and extensive practical preparations for the introduction of the euro. I will illustrate this point by presenting a few lessons which we have learnt from the earlier euro-area changeover.

- Third, I will touch upon what is still by far the most difficult and time consuming issue to be tackled, namely the mental or psychological changeover to the euro. It takes indeed years, and sometimes decades, for people to switch from one currency to another.

### ***1. Let me start with my first point: the macroeconomic achievements of the Slovak economy and the challenges ahead.***

Slovakia's growth performance throughout the last years has been remarkable and growth prospects seem bright – not the least due to forthcoming foreign greenfield investments. This should also create favourable conditions for addressing the challenge of high structural unemployment. Solving this problem requires a multi-faceted strategy, including measures to further enhance regional mobility and to reduce skill mismatches. Indeed, the Slovak national Lisbon strategy raises relevant issues and shows potential solutions.

The stable macroeconomic environment will help Slovakia to achieve nominal convergence with the euro area, a must prior to the entry into the euro area.

Following two years of high inflation, there now seems to be a good chance to stabilise inflation at low levels. The recent fall of year-on-year headline inflation to close to 3 percent is encouraging. Achieving a low inflation environment however requires that second round effects of the recently high adjustments in administered prices and indirect taxes be avoided and inflation expectations stabilized at a low level. The recent switch to explicit inflation targeting by the National Bank of Slovakia could be helpful to guide inflation expectations accordingly.

Concerning the fiscal area, the European Union's ministers of finance have just closed their discussion on Slovakia's November 2004 convergence programme. The fiscal strategy outlined in this programme aims at reducing the deficit to the 3% of GDP Maastricht criterion by 2007. Although this is in line with Slovakia's euro adoption strategy, the planned consolidation is back-loaded – even if one abstracts from the deficit impact of the pension reform. If one includes the

deficit impact of the reform, all the adjustment is basically postponed to 2007.

Against the backdrop of the very favourable macroeconomic environment, such an adjustment strategy does not look very ambitious. It would therefore be appropriate for Slovakia to seize every opportunity for a faster deficit reduction. This does not only refer to the use of higher-than-expected revenues for deficit reduction. It also includes the use of savings – and ideally also the implementation of additional measures – on the expenditure side to that end.

An accelerated consolidation strategy would create a safety margin against breaching the 3% of GDP deficit criterion in 2007 and would thus reduce potential risks for the implementation of Slovakia's euro adoption strategy. It would also further underpin the credibility of Slovakia's fiscal adjustment strategy in light of the planned ERM2 participation in the first half of 2006. Furthermore, it could assist in stemming appreciation pressures resulting from potentially surging capital inflows. And finally, accelerating the deficit reduction now would pave the way to achieving a structural budgetary position of close to balance or in surplus in the medium-term.

To conclude with this first point, I would like to address some comments in relation to the financial sector developments. Slovakia's successful bank restructuring and bank privatisation operations in the years 1999 to 2002 have placed the banking sector on a much sounder footing. To a similar effect, considerable improvements in financial sector supervision have been implemented. The Slovak financial sector is now much better placed for further development and the fulfilment of its intermediation role.

The potential for financial sector development is enormous and financial sector expansion goes hand in hand with rapid real convergence. Nevertheless, strong vigilance will be required in the process in order to guard against potential macro-financial stability risks. The recent publication of its first Financial Stability Report by the National Bank of Slovakia is a welcome step to increase awareness about potential challenges ahead.

### ***2. However, successful entry into the euro area requires not only fulfilment of the Maastricht criteria, but also extensive and timely practical preparations. This allows me to move to the second point of my speech.***

We should bear in mind that it took six years in total for the present euro-area countries to be fully prepared. However, certain lessons of the past will allow us to speed up the process in the future. In the case of Slovakia, the importance of careful practical preparations is particularly relevant since the country plans to introduce the euro in a so-called "big bang" scenario. Under



this approach, euro banknotes and coins become legal tender on the same date as the country's entry into the euro area. This is also the date at which the irrevocable conversion rate enters into effect.

I will try to draw some lessons from the previous changeover, which was a great success – although there is always room for improvement.

The experience of the first-wave countries clearly shows that countries which invested heavily in careful, pro-active and extensive preparations were rewarded. Their efforts were compensated in terms of speed of the changeover, public acceptance of the new currency and overall smoothness of the transition to the euro.

National governments and the public sector in general assume a particular role and responsibility. Their primary task is to draw up a comprehensive changeover scenario at an early stage. I notice that the Slovak government and the central bank have set the first steps in this direction by adopting a strategy for the adoption of the euro. This general framework will allow the private sector and the general public to complete their own preparations. Without such a framework, it is very difficult for individual companies to initiate their own preparations. Public administrations also have a general role of coordination, information and dialogue with various economic sectors and the general public.

In order to foster discussion among future euro-area entrants, the Commission has re-launched the Public Administration Network (PAN II) in which all the 13 current pre-in countries are represented. In the past, the PAN was an essential forum for discussion and exchange of views among the national representatives in charge of the changeover in their respective countries. It will again play a very important role in the future.

***3. Let me now move to the third and last element which I wanted to raise, namely the mental or psychological changeover which constitutes the most difficult part of the whole exercise. This refers to issues such as the generally erroneous perception of price increases, or to the difficulty for many people to start thinking and calculating in euro. It is obviously easier to change the content of people's purses than to influence their minds.***

Nevertheless, it is essential to address this point. Public opinion, as expressed in people's general attitude towards the euro, is a too important political force to be ignored. And much can be done to avoid myths and misperceptions: we know this from past experience. There is no reason at all to be fatalistic about public opinion.

In this respect, Slovakia is moving in the right direction but there is still a lot of work to be carried out.

- Firstly, Slovak citizens need more extensive infor-

mation about the practical consequences of the euro. The better citizens are informed, the least apprehensive they are about changing currencies. The prime cause of fear and resistance is ignorance. Yet, according to the Commission's Eurobarometer survey of October 2004, 70% of the Slovak population consider themselves not well-informed about the euro. This may explain the fact that 33% of citizens would like it to be introduced as late as possible. These figures are a cause for concern and action should be taken to remedy the situation.

A national working group which will deal with communication issues has already been established and had its first meeting a couple of weeks ago. This Committee should be put into action as soon as possible. Slovakia has still time and the country has taken the correct steps to accomplish a successful mental changeover.

The European Commission stands ready to help in the form of a partnership agreement. It is prepared to share part of the financial burden under its communication programme.

The time has come to set up and implement a comprehensive information plan which will make sure that Slovak citizens are among the best informed about their future currency.

- Secondly, concerning the general perception of price increases related to the euro, the results of the latest Eurobarometer poll provide little comfort. 64% of the Slovak population fear that there will be abuses and price cheating during the changeover. These prevailing attitudes among the general public call for corrective action. Firstly, we should address the unfortunate but real possibility of price increases in certain, generally well-defined, sectors. Secondly, consumers' perception of price increases should also be tackled. Both effects can only be counteracted by preventive action and confidence-building measures such as dual display of prices (starting well before the changeover), codes of conduct and/or specific agreements between retailers and consumers, individual commitments by retailers to correctly converting prices, and so on.

- Thirdly, regarding the mental changeover, I acknowledge that this process invariably takes considerable time. For example, survey results relating to the euro area show that the majority of citizens still calculate in national currency for large-value purchases (for example, when they buy a house or a car). The mental switcher appears to be considerably faster for small-value items. The early introduction of dual displays helps considerably. However, let us not forget that an exit strategy will be needed. Dual displays assist consumers in their mental changeover to the euro. Keeping them in place for too long, however, could have the per-



verse effect of prolonging the reference to the national currency beyond what is necessary.

### Conclusion

Let me now conclude. Slovakia is developing and implementing a reform process that is leading the country towards a successful adoption of the euro. There are still a number of challenges lying ahead but the country is fully aware of them and making efforts in the right direction.

The introduction of the euro does not only require the fulfilment of the Maastricht criteria. Indeed, we know from the experience of the first wave that candidates for euro-area entry should prepare themselves well in

advance if they want to ensure a smooth changeover to the euro.

Finally the mental (or psychological) changeover constitutes the most delicate and unpredictable element of the process. But, here again, a lot can be done to avoid unnecessary problems, notably in terms of information to the citizens. Slovakia has still time and it should continue making efforts in this respect.

I strongly encourage Slovakia to continue with its reform process and the implementation of its strategy for the euro adoption.

I would like to reiterate my earlier commitment that the European Commission will contribute as much as it can to a successful changeover in all future euro-area entrants.