Adopting the Euro: A Long Path towards National Consensus within the Euro Area Candidate Countries

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Abstract: The global financial crisis outbreak after 2007 has profoundly changed the course of the history of relations in the world economy, creating a complicated framework of political relations between countries and economic regions. In this context, it is important to depict the economic convergence stage of Euro Area candidate countries and to what extent this crisis has or has not changed the euro adoption objective for these countries. The present paper aimed to shed a light on this issue by analyzing both the state of the convergence process and the public attitude regarding euro adoption in four Euro Area candidate countries which have the same monetary policy strategy (inflation targeting). The research results show the way in which the global financial crisis "deviates" the convergence trajectory of the nominal indicators, but also the political and public sentiment against the euro adoption in the selected countries. The results represent a valuable groundwork for analyzing the way in which National Central Banks candidate to the Eurosystem are implied into the processing for euro adoption during turbulence times

Keywords: Nominal convergence; central bank policy; political view; public opinion

JEL Classification: F15; F36; F45; G01

1 Introduction

Since the establishment of the Economic and Monetary Union, decision-makers from member states of the Euro Area considered that a single currency will promote economic and political convergence between countries (Pop et al., 2011). Nevertheless, the experience of more than fifteen years shows a very convoluted path of monetary integration in Europe. The internal problems of Euro Area have been seen in time, but they have worsened with the European financial crisis outburst, Lehman Brothers collapse being the major shock which generated a series of challenges, including those related to the continuity of the European project (Lupu & Criste, 2013).

After joining the European Union, the Central and Eastern European countries are expected to enter the last stage of Economic and Monetary Union. The first of them,

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Slovenia, have adopted the single currency in a different period (before the global financial crisis outbreak), and Slovakia, immediately after the Lehman Brothers shock. For these countries, euro adoption condition were different (see Criste, 2012) than for the countries which are still candidate countries to the Euro Area. Although the global financial crisis hindered the economies of the Baltic States, they kept up to adopt the euro currency; so that all the three are already member states of the Economic and Monetary Union (Lithuania became recently the 19th member state of Euro Area). The remaining countries (Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania) are still on their way to becoming members of this monetary union.

Although the formal condition for entering Euro Area is the fulfilment of the nominal convergence criteria, being stipulated in the Maastricht Treaty, these conditions have not ensured a viable monetary integration in the Euro Area (Pop et al., 2011). Furthermore, the economic convergence process is not an irreversible one, and the developments of the macroeconomic indicators playing the role of nominal convergence conditions must be related to the trends of the real economy. Even though there are such limitations, the nominal convergence remains a precondition for euro adoption and thus it is necessary to be taken into account as a starting point in evaluating the economic convergence process of the European Union countries.

The analysis of the economic convergence offers useful insights, but it could not explain the strategy of euro adoption for the candidate countries to the Economic and Monetary Union. In this context, Dandashly and Verdun (2011) explain that the process for euro adoption include not only a cost-benefit analysis, but also a political one. By the same token, Dyson (2006), Johnson (2008), and Greskovits (2008), assess the euro adoption process taking into account some political criteria such as: the policy learning, the transfer of ideas and knowledge among central bankers, the adjustment to the global pressures and to the Europeanization current, and they conclude that the political features plays an important role in influencing the euro adoption strategy.

Analysing the situation of three of the candidate countries to the Euro Area, namely Czech Republic, Poland and Hungary, Dandashly and Verdun (2011) argue that the euro adoption timing depend on the domestic politics climate. This climate is defined by the domestic problems and the internal conflicts between public institutions (central bank vs. government) and their visions regarding the European project (euro sceptical view vs. euro enthusiastic view).

2. Methodology and Data

The euro adoption process represents the two sides of the same coin, because it implies on the one hand, an economic analysis for evaluating the convergence process (not only the nominal convergence as a precondition imposed by the Maastricht Treaty, but also a sustainable convergence of the real economy) and on the other side, the political preferences. Our analyses resumed to the European emerging countries candidate to the Euro Area which have some common features: they have a similar strategy of monetary policy (inflation targeting), they have a flexible exchange rate and they do not yet enter the Exchange Rate Mechanism II: Czech Republic, Hungary, Poland and Romania. We firstly evaluate the nominal convergence stage and secondly, the domestic climate concerning political preferences and public opinion for euro adoption.

Table 2. The nominal convergence criteria

Criterion	Price stability	Sound public finances	Sustainable public finances	Durability of convergence	Exchange rate stability
Indicator	HIPC inflation rate	Government deficit as % of GDP	Government debt as % of GDP	Long-term interest rate	Deviation from a central rate
Condition of nominal convergence	Not more than the reference value, as the rate of the three best performing Member States plus 1.5 pp.	Not more than the reference value (3%)	Not more than the reference value (60%)	Not more than the reference value, as the rate of the three best performing Member States in terms of price stability plus 2 pp.	Participation in ERM II for at least 2 years without severe tensions

Source: European Commission

In order to spotlight the changes induced by the global financial crisis regarding the euro adoption process in the selected countries, we analyze the stage of the nominal convergence, as an initial condition for euro adoption (the nominal convergence criteria are presented in Table 1) and the attitude of both the citizens and political class concerning the euro adoption in the selected countries. For that purpose, we take into consideration an extended period of time (2004-2014), with Lehman Brothers shock as benchmark for starting the European episode of the global financial crisis. We use Eurostat data for nominal convergence indicators, Flash Eurobarometer surveys and Annual Reports of National Central Banks to extract information regarding the public opinion and the political decisions.

3. Results

3.1. The State of the Nominal Convergence

As it is shown in Figure 1, the reference rate for HICP inflation decreases significantly after Lehman Brothers shock, but the selected countries were at grips with this indicator, especially Romania and Hungary. After 2012, it is remarked a convergence of HICP inflation rates for all these four countries.

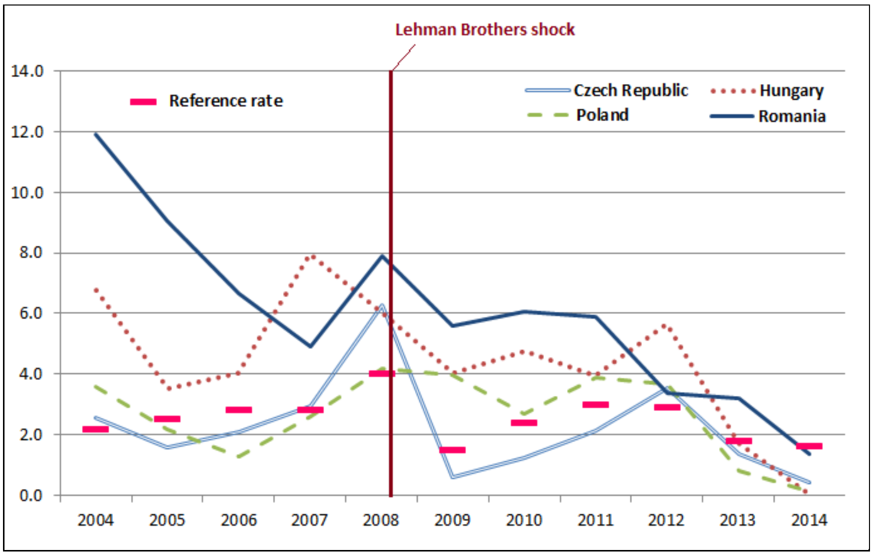

Figure 1. The HICP inflation in the Czech Republic, Hungary, Poland and Romania (12-months' average of yearly rates, %)

Source: Eurostat data, author's calculations

The inflationary pressure has been diminishing since 2009, not as a direct and exclusive effect of the global financial crisis manifestation, but as a result of the Central Banks pursuing of the price stability as their primary objective. One of the main reasons refers to National Banks' aiming at forming and maintaining lower levels of the inflation expectations, during that period.

As concerns the long term interest rate criterion, since 2006, Romania and Hungary registered the highest levels and exceeded the most frequently the reference level: Hungary exceeded seven times, and Romania, six times. As it is depicted in Figure 2, all four countries meet the interest rate criterion in the last two years (in 2013 and 2014).

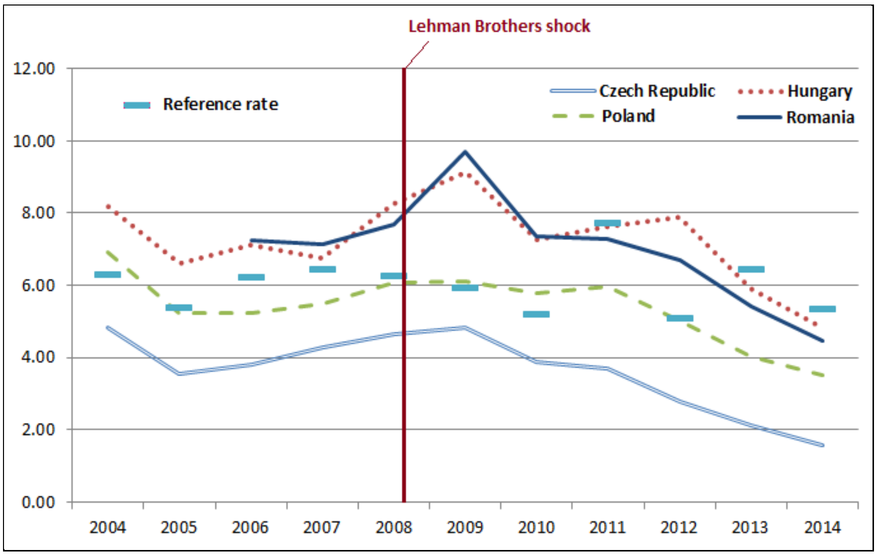

Figure 2. The long-term interest rate in the Czech Republic, Hungary, Poland and Romania (average yields for 10 years government bonds, %)

Source: Eurostat data, author's calculations

The global financial crisis put pressure on the fiscal criteria of the nominal convergence, as the general public deficits have worsened in 2009 (see Figure 3), and the public debt increased at a faster pace during 2008-2011 (see Figure 4).

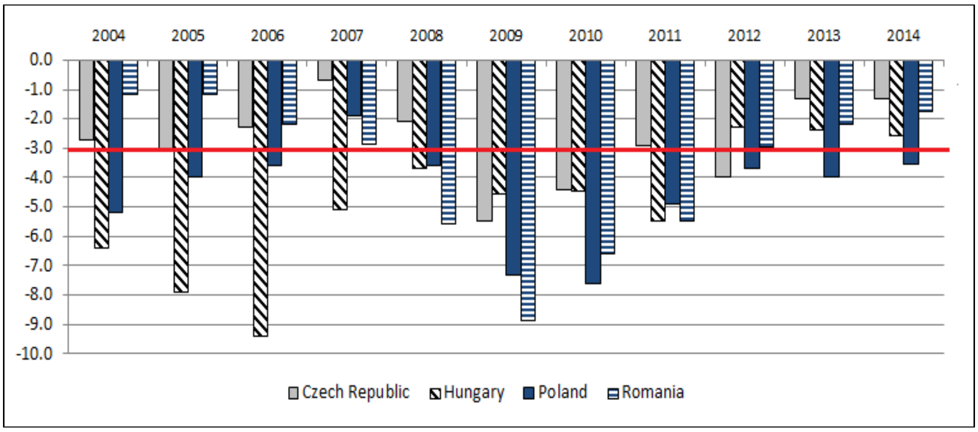

Figure 3. The general public deficit in the Czech Republic, Hungary, Poland and Romania (as % of GDP)

Source: Eurostat data

In 2009-2010, the effects of the global financial crisis were reflected by the huge rates of this indicator in all countries, Romania and Poland being in the worse position. Nevertheless, in recent years, after 2011, there is a tendency for improving of this indicator in these countries, except Poland which is in the Excessive Deficit Procedure, since 2009. Measures taken by the Polish Government are expected to reduce the nominal deficit in 2015 to 2.5% of GDP, below target recommended by the European Council (2.8% of GDP).

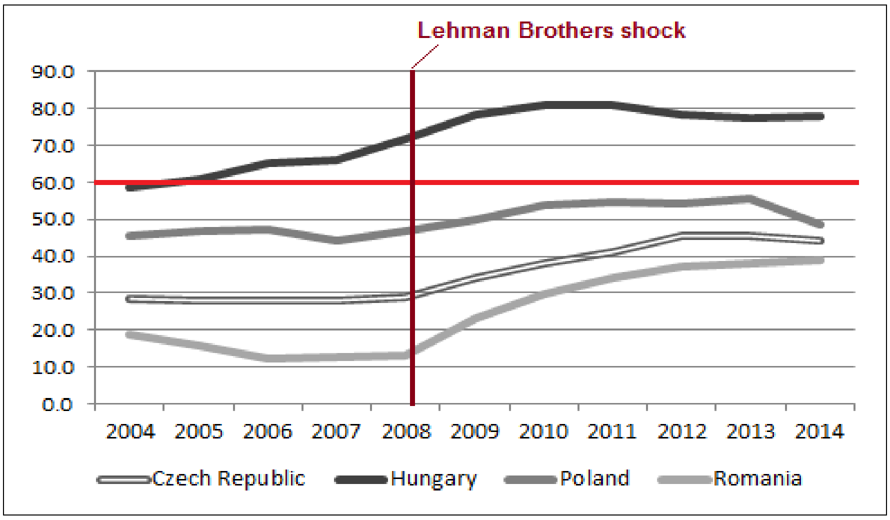

Figure 4 The public debt in the Czech Republic, Hungary, Poland and Romania (as % of GDP)

Source: Eurostat data (for 2004-2013); Ameco data (for 2014)

Concerning the public deficit, Hungary attained the highest levels of this indicator, even before the global financial crisis outbreak, exceeding constantly the reference value (60% of GDP), since 2005. Although the other three countries meet this criterion, the public debt has increased more pronounced during 2008-2013.

None of the four countries participated in the ERM II, but analysing the potential fluctuations of the national currencies, we can assess if the exchange rate developments of the national currencies are enrolled in the admissible band of fluctuation (±15%). As it is depicted in the left panel of the Figure 5, national currencies of Poland, Hungary and Romania exceeded the admissible band, during 2008-2009, but after 2013, all the four currencies had stable evolutions, so that the exchange rate criterion should be currently considered fulfilled.

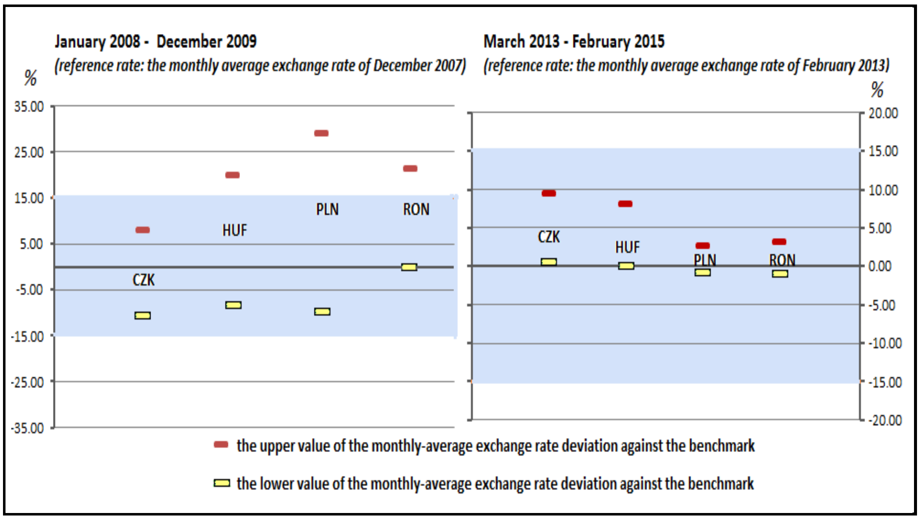

Figure 5. Spread of the exchange rate fluctuations for Euro Area candidate countries

Source: Eurostat data, author's calculations

Note: We consider a two-year period (the minimum period for participating in the ERM II) in order to evaluate the exchange rate fluctuations of the four national currencies against the euro. Because it is not officially announced any central parity for the four national currencies exchange rates, we take as benchmark the monthly average exchange rate level of the previous month of the reference period (i.e. for January 2008-December 20109, we consider the exchange rate level of December 2007; for March 2013-February 2015, we consider the exchange rate level of February 2013).

During March 2013 - February 2015, the Czech koruna (CZK) has a larger depreciation than the other currencies and this is explained by the new "framework" of the monetary policy choosing to use the currency exchange rate as an additional monetary instrument, as the policy interest rate was already at the zero lower bound. Thus, in November 2013, the Czech National Bank Board decided to depreciate the koruna by 4.5%, pursuing to prevent the nominal appreciation under the level of 27 CZK/EUR.

As a general observation of this section of the paper, we can underline that the candidate countries have recently improved the nominal convergence path, although Hungary continue to be in a vulnerable position relative to the public debt (see Table 2).

Table 2. The nominal convergence gap1) in 2008 and 2014

	2008					2014				
	HICP inflation gap2)	Long-term interest rate gap2)	Public deficit gap3)	Public debt gap4)	The exchange rate fluctuation5)	HICP inflation gap2)	Long-term interest rate gap2)	Public deficit gap3)	Public debt gap4)	The exchange rate fluctuation5)
Czech R.	+2.3	-1.6	+0.9	-31.3		-1.2	-3.8	+1.7	-15.9	
Hungary	+2.1	+2.0	-0.7	+11.9		-1.6	-0.5	+0.4	+17.7	
Poland	+0.2	-0.2	-0.6	-13.4		-1.5	-1.8	-0.6	-11.4	
Romania	+3.9	+1.5	-2.6	-46.8		-0.2	-0.9	+1.2	-21.3	

Source: author's calculation based on Eurostat data.

Notes: 1) The nominal convergence gap is calculated as the difference between the reference value and the value recorded for each indicator and in each country; 2) The positive values show the excessive levels against the reference value (failure criterion - marked with dark-grey colour); 3) The positive values show the fulfilment of the Maastricht criterion (marked with light-grey colour), and the negative ones show the excessive levels to the limit imposed; 4) The positive values means excessive levels to the limit imposed (marked with dark-grey colour), and the negative ones denote a lower level of public debt than the Maastricht limit; 5) The exchange rate fluctuation of the national currency against euro is calculated according to the methodology described above (the note of the Chart 5). We marked with light-grey colour, if the exchange rate values are within the ±15% limits, and with dark-grey colour, if the exchange rate values exceed those limits.

3.2. Opinions Regarding the Euro Adoption

The effects induced by the global financial crisis on the Euro Area periphery (namely, on the economies of Greece, Spain, Portugal, Ireland) amplifies the fears related to the potential risks of euro adoption in the candidate countries. In fact, the global financial crisis changed the balance between the cost and benefits of euro adoption, enhancing the first ones (costs) and blurring the latter ones (benefits), not only because of the economic and financial vulnerabilities of some member states, but also because of the Euro Area project itself, which is an unfinished project.

Annual Reports of the National Banks from these countries highlight that the euro adoption strategy was one of the main objectives before the global financial crisis outbreak, but the challenges emerged from the new context, after September 2008, have changed the priorities of the national authorities, including the timing for euro adoption.

Based on the National Convergence Programs and Annual Reports of National Banks from the Czech Republic, Hungary, Poland and Romania, we find that the initial target date for euro adoption was pushed forward in an uncertain future (see Table 3).

Table 3. The target dates for joining the Euro Area have changed in time

Country	The last date for euro adoption before the global financial crisis	During the global financial crisis	Currently statements for euro adoption
Czech Republic	**2009-2010** - according to *The Czech Republic's Euro-area Accession Strategy* (2003)	In July 2010, the new Czech government decided not to fix the date for euro adoption	**Not a target date**
Hungary	**2008** - according to the Official euro adoption strategy (August, 2003) **2010** - according to the first Convergence Programme (May 2004)	In 2009, the target date has been postponed again and analysts estimate an adoption of the euro by 2014	**Not a target date**
Poland	**2008/2009** - according to the Economic Pre-aderation Programme (2003)	The Polish Prime Minister Donald Tusk announced in December 2008 that Poland should strive to adopt the euro as early as 2012	**Not a target date**
Romania	**2014** according to the Convergence Programme (2004)	According to its Annual Report 2009, the National Bank of Romania assessments indicated 2012 as a desirable moment for entering in ERM II (**1 January 2015** - the new target date for euro adoption)	**1 January 2019** is a proposed target date by the Government within the Convergence Programme 2014-2017

Source: Author's representation based on the National Convergence Programs and Annual Reports of the National Banks of Czech Republic, Hungary, Poland and Romania

At the political level, these four countries have different approaches regarding the target date for euro adoption. While the Czech Republic, Hungary and Poland use the "wait and see" approach, Romania has already set a target date for euro adoption. Although Romania has a target date and a National Co-ordinator institution, it has not yet a National Euro Changeover Plan, like the other three countries. Furthermore, the Czech Republic and Poland have a more advanced path concerning the technical preparation for euro adoption. Beside the National Co-ordinator institution for euro adoption (since 2005) and the National Changeover Plan for euro (since 2007), the Czech Republic has an updated national strategy for Euro-area Accession (since 2007). In December 2014, the Czech government approved a joint document of the Ministry of Finance and the Czech National Bank regarding the assessment of the fulfillment of the nominal and real convergence of the Czech Republic with the Euro Area. Poland has also a National Euro Changeover Plan (since 2010), a national strategy for Poland integration with the Euro Area. Recently (in November 2014) the National Bank of Poland released a document regarding the economic challenges of Poland's integration with the Euro Area.

However, central banks, including the National Bank of Romania, are more reluctant to a rapid euro adoption, highlighting the importance of both the sustainable economic convergence and the political and social consensus. Like the other central banks candidate to the Eurosystem, the National Bank of Hungary has a major role in monitoring the convergence process of the euro adoption by publishing regularly a Convergence Report. Nevertheless, in the recent years, it seems that the interest for this subject is decreasing, because the last Report was published in 2011. It contains a detailed analysis related to the risks and benefits of introducing the euro in Hungary. The Czech National Bank remains reluctant to set a target date, but this reluctance has increased in the recent years as a result of both the Euro Area sovereign debt crisis, and the political instability between the "periphery" and the "core" countries. The same attitude is seen in case of the National Bank of Poland, which considers that the Euro Area unsolved internal problems represent a major hedge for a future integration of Poland in the Euro Area.

Furthermore, the debates on the early entry of the Czech Republic into Euro Area have recently showed a cleavage between the Ministry of Finance and the Czech National Bank, on the one side, and the Presidency, on the other side. The first ones don't agree with the idea to adopt the euro until at least 2018, while the president and the prime minister want an early adoption of euro. In the same situation, the euro adoption objective became a subject for election campaign in Poland. The conflictive situation in the domestic field amplifies the already precariously conditions for the future of Euro Area enlargement.

The public opinion regarding euro adoption in the selected countries is based on the official data of the Flash Eurobarometer Report (June 2014).

As the Figure 6 shows, these opinions differ among citizens from the four countries, both during or immediate after the EU accession (2007) and after the global financial crisis (2014). Comparing those two moments, there is a downward trend for Czech Republic, Poland and Romania regarding the proportion of people which are in favour of the single currency. Nevertheless, Hungary has maintained a constant level (50%) in this regard. The most obvious falling of this level is registered by the Czech Republic (from almost 50% to 26%), Czechs being the most attached to their national currency. On the opposite side is Romania and Hungary, which maintained higher levels in terms of percentage of responders in favour of euro adoption. Although these results show that the euro is viewed by the citizens of Romania and Hungary as providing a greater protection, it is important for national authorities to inform people not only about the potential benefits of euro adoption, but also about the potential risks generated by giving up to an important shock absorption instrument and by a “too hasty” euro adoption.

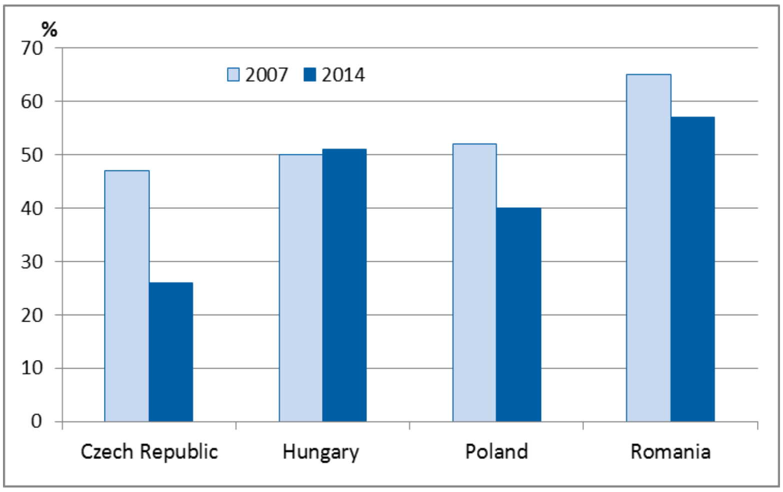

Figure 6. Changing the public opinion regarding the euro adoption Euro Area candidate countries (the proportion of the questioned people who see positive consequences of euro adoption at the national level)

Source: Flash Eurobarometer 400 Report, June 2014

The same Report highlights that the public opinion of these countries views differently the timing for euro adoption. Hence, Romania has the highest percentage of questioned people (44%, in 2014) who are in favour of joining the euro as soon as possible. On the opposite side is the Czech Republic, with the lowest level (6%, in 2014), followed by Poland (11%) and Hungary (22%).

4. Conclusion

One of the general conclusions arisen from our analysis refers to the uncertainty of euro adoption as main objective for these four countries, as the global financial crisis changed their national priorities. During the analysed period, the path of euro adoption has changed. Before the Lehman Brothers shock, the target date for euro adoption was very challenging in these four countries, in spite of the undeveloped stage of some Maastricht criteria fulfilment, at that moment. Conversely, after 2009, the nominal convergence attains an advanced stage in these countries, but the attitude regarding the euro adoption becomes more prudent, as the global financial crisis effects reveal a more complex area of costs concomitant with a reduced area of benefits for joining the Euro Area. The subject of this paper could be developed by including indicators which describe the real convergence of these countries with the Euro Area, as it could depict new features. We also notice that there is no relation between public opinion and the fulfilment of the nominal convergence criteria. Although the Czech Republic meets all five criteria, the public opinion is the most unfavourable to the euro as a national currency. Instead, Hungary has some problem with the public debt, but the public attitude towards euro adoption is more enthusiastic. In the near future, the euro adoption process in the selected countries remains a conflictive subject at the national level. In spite of the economic (nominal) convergence tendency, there is a political divergence between national authorities. From the political point of view, an important objective for the decision-makers is to increase the awareness and to enhance the knowledge of the public concerning the often intricate issues of participation in Monetary Union highlighting not only the benefit, but also the potential risks emerging from the decision to abandon the national currency.

5. Acknowledgment

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