SLOVENIA ON ITS WAY TO THE FINAL STAGE OF ECONOMIC AND MONETARY UNION

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Abstract: The Maastricht Treaty states certain criterias that have to be achieved in order for a EU Member State to qualify in undergoing the 3rd stage of UEM, the introduction of the euro.In 2007 Slovenia passed this stage, following a well defined and coherent strategy, based on a long time planning, based on the cooperation between the Government and the National Bank.Thus, the experience of switching to euro implemented in Slovenia represents a model for other countries, including Romania.

Key words : nominal convergence, real convergence, inflation, euro

1. The convergence criteria for adoptation of euro

Nominal convergence

The Maastricht Treaty specifies that, in order for a EU member State to adopt euro, it is necessary for it to fulfill certain criteria of nominal convergence:

- the rate of inflation criteria: the rate of inflation should not exceed with more than 1.5 pp the rates of inflation of 3 EU member states that have the highest price stability;
- the criteria of the interest rate: the interest rate should not exceed with more than 2 pp the average interest rate of the 3 EU member states previously taken into consideration;
- Fiscal criteria: the lack of a decision of the Council regarding the existance of an excessive budgetary deficite (based on respecting the limit of 3% of the GDP for the deficite and maximum 60% of the GDP for the Public Debt);
- The exchange rate criteria: the exchange rate has to respect the normal fluctuation margins provided by the Exchange Rate Mechanism for a period of at least 2 years before the examination, without the devaluation of the currency related to the euro.

After the candidate state has become an EU member, the next step represents the adhesion to ERM II with a view to the adoption of the euro.

Real convergence

Regarding the real convergence process, there are no formal criterias and no complete agreement regarding the variables that should be taken into consideration; some of them reffer to the growing rates of the GDP per capital and of the productivity in the different sectors of activity from the GDP share.

Untill the 1990s the EU was formed by states that were sharing the same economic structure, thus the real convergence became a fact (even if the Maastricht Treaty doesn't reffer to it) only after the joining of Central and Eastern countries.

In regards to the real convergence there are no formal criterias and no total agreement regarding the variables that should be taken into consideration; some of them reffer to the rates of growth of the GDP per capital and of the productivity as part of the different sectors of activity from the GDP, others to the evolution of the degree of economic intergation.

2. An anysis on the achievement of the criterias by Slovenia

Nominal Convergence stage

Slovenia achieved the convergence reports in order to achieve the convergence criterias set by the Maastrich Treaty and succeeded in coordinating it's economic policies with the other states based on the directions set by the Commission.

The annual inflation average, used in evaluating the convergence, decreased from 8.6% in 2001 to 2.3 % in march 2006.As a result, it came near progressively to the refference value and reached it for the first time in november 2005.

Thus, during the reference period, from april 2005-march 2006 the average inflation rate in Slovenia was 2.3% under the value of reference of 2.6% regarding the price stability criteria. Even if this positive aspect was recorded without major fluctuations after 2000, Slovenia had to be careful in maintaining it's low inflation environment

Tabel 1. Inflation in Slovenia

	Dec. 2005	**Ian. 2006**	**Feb. 2006**	**Mar. 2006**	**Apr.2005 – Mar. 2006**
HICP inflation	2,4	2,6	2,3	2,0	2,3
Reference Value					2,6

Source : European Comision (Eurostat)

During the last years, the level of the long term interest in Slovenia went on a decreasing trend, that constantly decreased in regards to the euro zone, starting 2002.The main factor that generated this was the elimination of the economic and financial uncertainty, due to the cautious monetary and fiscal policy measures and also the reduction of inflation in regards to the euro zone. Further on, the reduction of the interest's differential level benefited from the market's trends regarding the transition to ERM II, that took place in 2004, as well as of the tolar/euro exchange rate starting that date. The convergence process of the interest was also sustained by the tendencies of the adoption of the euro.

In conclusion, the interest rate in Slovenia followed the euro zone level, reflecting the market's trust in the economic, fiscal and monetary policies as well as the currency exchange rate.

During the reference period, from april 2005-march 2006, the long term interest rate was approximately 3.8% average, under the reference value of 6.2% set by the level of interest criteria.

Tabel 2. Long-term interest rate developments

	Dec. 2005	**Ian. 2006**	**Feb. 2006**	**Mar2006**	**Apr. 2005-Mar. 2006**
Long term interest terrm	3,7	3,7	3,7	3,8	3,8
Reference value1)					6,2

Sources : European Comision and European Central Bank

1) Calculation for the April 2005 to March 2006 period is based on the unweighted arithmetic average of the interest rate levels of Poland, Finland and Sweden, plus 2 percentage points.

Regarding the budgetary deficite criteria, Slovenia reported a deficite of 1.8% of the GDP, way below the refference value of 30%.The public debt was 29.1%, below the refference value of 60%.

Tabel 3. Fiscal developments

	2004	**2005**	**2006**
Deficit	-2,3	-1,8	-1,9
Reference value	-3,0	-3,0	-3,0
General government dept	29,5	29,1	29,9
Reference value	60,0	60,0	60,0

Source : European Comision and European Central Bank

The slovenian currency participated to ERM II since 28th of June 2004, for approximately 22 months from the2 years reference period from april 2005-march 2006.The reference value for the tolar was settled at 239.64 tolar/euro, this being the market value at that date, Slovenia not devaluating the tolar at it's own initiative. A fluctuation rate of was settled at +_ 15% around the central value.

Tabel 4. Exchange rate developtments

Membership of ERM II	yes	
Membership since	28/06/2004	
Devaluation of bilateral central rate on country's own initiative	no	
Maximum upward and downward deviations 1)	Maximum upward deviation	Maximum downward deviation
28 iunie 2004-28 aprilie 2006		
Euro	0,1	-0,2

Source :European Central Bank

1) Maximum percentage deviations from ERM II central rate. Ten-day moving average of daily data at business frequency.

It is very interesting to make a comparison with the ten states that joined the EU at the 1st of May 2004.Together with Slovenia, Poland accomplished the criterias in the refference period of April 2005-May 2006.After a further analysis we can see that only 2 other states-the Czech Republic and Cyprus accomplished the inflation criteria. Regarding the budgetary performance criteria in the 8 states that recorded budgetary deficites, only 3-Cyprus, Malta and Lithuania bordered around the refference value.Regarding the public debt, Cyprus, Hungaria and Malta recorded values above the refference value.It is interesting to observe that, regarding the interest rate, only Hungaria placed itself above the interest rate (for Estonia there weren't statistical data because the finacial system in this country is caracterized by the lack of a developed market).

Tabel 5. Indicatory of economic convergence

		Inflation	Surplus/deficit	General government dept	Long term interest rate
Czech	2005-2006	2,2	-3,5	30,9	3,8
Estonia	2005-2006	4,3	+2,5	4,0	-
Cyprus	2005-2006	2,3	-1,9	64,8	4,1
Latvia	2005-2006	6,7	+1,0	11,1	3,9
Lithuania	2005-2006	2,7	-0,5	18,0	3,7
Hungary	2005-2006	3,5	-10,1	67,6	7,1
Malta	2005-2006	3,1	-2,9	69,6	4,3
Poland	2005-2006	1,2	-2,2	42,4	5,2
Slovenia	2005-2006	2,3	-1,8	29,1	3,8
Slovakia	2005-2006	4,3	-3,4	33,0	4,3
Reference value		2.6%	3%	60%	6.2%

Sursa: BCE, Eurostat and European Comision

1).The satibility of the exchange rate is not included.

2).Average percentual modifications.The data for 2005-2006 reffer to the reffrence period of November 2005-October 2006.

3). The refference value reffers to the November 2005-October 2006 period

Real Convergence study

After the real growth of the GDP was artificial between 2001-2003, it began to increase again in 2004, continuing to be slower that in other states. The conditions of the labour market remained stable, the unemployment rate fluctuating between 6 and 7%.The compensations for the increasing of the employed personnel reached decimal numbers in 2000 and 2001, then decreasing to 7.7% in 2004.The slowing of the labour productivity growth resulted in a substantial groth of the labour cost in 2000 and 2001, followed by a gradual decline down to 3.8% in 2004.

3. The introducing of the euro - a real success

All this success was based on a single leit motif: the importance of the preparation of introducing the unique european currency. The slovenian people were already accustomed with the utilization of currencies, due to it's geographical proximity to states that were already, for a few years, the habit of utilizing these currencies, but also due to the close economic relations and to the payments performed in euro. Actually, the introducing of the unique european currency was rushed even more than in 2002, almost

80% of the totals on the market came to the Slovenian Bank on the 11th of January (in the countries that adopted the euro in 2002 the percentage was 40%).

Like the citizens of the other states, the Slovenians expressed their worries about that possible changes in prices and about the impact of inflation.The majority of prices even decreased during January, compared to december 2006.The inflation reached 2.6% compared to 3% in December 2006.Overall, the prices increased with 1.3&, compared to the same period in 2006, when the value was 1.5%. Regarding the public and private sectors, the introduction of the euro was a success, due to several factors: a careful planning that began more that 3 years before, the special attention payed to the complexity of the project and regular testings. Small companies instructed their departments and anticipated the changes that came after the 1st of January. Citizens and companies that had been well informed in regards to the practical consequencesof the introducing of the unique european currency dealed with minimal difficulties.Thus, the Slovenian public's eye confirms once again the crucial role of informing and communication in the success of the transition process.

Conclusions

Slovenia shifted to ERM II only a few months after joining the EU, beeing the only state, among the ten other states, that adopted the euro on the 1st of January 2007.It defined very well it's strategy regarding ERM II, succeeded in not devaluating it's currency and thus had not to wait another two years until the moment of adopting the euro.

As a second entrant country, Slovenia took advantage of other euro zone countries good practices' at the time of euro adoption. Based on the experience of other countries, the government and the Bank of Slovenia took measures to ensure a smooth transition to the euro. Notably, Slovenia adopted dual pricing nine months prior to the euro changeover, and lead an information campaign aimed at informing the broad public about the possible risk in the process of the currency changeover. As a result, inflation remained stable in the month prior to euro adoption and immediately after it. Average inflation stayed stable at 2.5 % in the last three months, whereas year-on-year inflation amounted to 2.3 % in November 2006 and declined to 2.1 % in February 2007. The euro changeover has not affected long-term inflation dynamics, but has had a significant effect on some groups of the CPI, notably on services in restaurants and cafes.

The lessons from Slovenia, where the changeover process went very smoothly with much public support, demonstrates the value of a well-planned extensive information campaign. As other Member States prepare their citizens for the euro, communication and information will play a major role in ensuring the process goes smoothly and that it is supported by the public. The issue of inflation perceptions as opposed to reality was an issue for Slovenia as it was in the firstwave countries. Slovenia did not fully succeed where others also partly failed, i.e. in avoiding perceived inflation starting to diverge from actual inflation in the context of the changeover. The perception that some retailers see the introduction of the euro as an opportunity to put up prices remained. In the light of the Slovenian experience, it is possible to say that caution should be exercised in placing too heavy a reliance on dual price display as an anti-inflation measure in itself, and that more emphasis should be placed on fair-pricing agreements.

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