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THE COUNTRIES IN TRANSFORMATION ON THE WAY OF THE EUROPEAN MONETARY UNION

The National Bank of Slovakia and the Ministry of Finance are interested in Slovakias joining the EMU as soon as possible. It could be realized simultaneously with its neighbours, e.i. Czechia, Hungary, Poland and Slovakia. An optimistic time schedule of the Slovak Republic joining the European Monetary Union could be defined by three time phases:

1st phase – up to SR's joining the European Union in 2004. In this phase it was necessary to fulfil the Copenhague criteria – political, economic and other, to choose the adequate exchange rate system, to implement the European law – the acquis communautaire, to liberalise capital flows and deregulate end liberalise prices;

2nd phase – two years after joining the European Union. In this phase the National Bank of Slovakia will become member of the ESCB, the fiscal policy will become common interest of the EU and up to 2006 the Maastricht criteria will be fulfilled;

3rd phase – approximately 2007 – 2008 – introduction of the euro. Not only the actual fulfilment but also the further fulfilment of the Maastricht criteria has to be guaranteed. In 2007 the fulfilment of the Maastricht criteria will be checked and in 2008 the SR will join the EMU and introduce the euro. It is supposed that GD grow after having joined the EMU at 1% additionally.

1. THE ADEQUATE EXCHANGE RATE SYSTEM IN THE FIRST PHASE OF THE JOINING PROCESS

In the joining contract with the EU the SR has accepted to become by the day of joining the EU a member of the Economic and Monetary Union as a member country with derogation according to the article 122 of the

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EU contract. That means at the same time that it can no more decide whether to join the EMU or not. It has to join the EMU and only the time horizon of the joining is to be decided.

In the first phase it has to fulfil all legislative conditions, first of all the prohibition of financing the public sector by the central bank, the prohibition of a privileged position of the public sector face to face the banking sector and full liberalisation of capital flows. In this period the country is fully independent in its monetary policy, including the exchange rate policy and is step by step accomodating the instruments of its monetary policy to the monetary policy instruments of the European Central Bank in order to guarantee the step by step joining of the EMU. For small and open economies as the economy of the SR is, the choice of an adequate exchange rate system making possible the problemless acceptation of the euro and a normal and real convergency of the economy is crucial. In the exchange rate policy there exist no special claims as to the possible exchange rate systems for the candidate countries. They can use fixed exchange rates, a currency board t. the euro, free and managed floating. Three of the candidate countries use a currency board (Bulgaria, Estonia and Lithuania), four countries a managed floating (Poland, Slovakia, the Slovak Republic and Romania with different nominal anchors – from inflationary targeting up to M 3 growth targeting, Latvia has a fixed exchange rate depending from SDR, Hungary a central parity versus the euro and a ± 15% fluctuation zone and the Czech Republic free floating with inflationary targeting.

The SR is a country with low inflationary expectations and a relatively low inflation in the whole period of its existence. It has problems in the fiscal field and in the current account of the balance of payments. In the 10 years of its existence the SR several times had to fight with the problem of so called double deficit (excessive deficit of public finance and high deficit of the balance of payments current account). In order to consolidate the disequilibrium not sustainable for a long time it had to accept relatively drastic economic measures (the reforms realised in 1999–2000 and 2003–2004). The growth of inflation was influenced first of all by administrative measures, as deregulation of prices, changes in taxation and not by an internal disequilibrium. This leads immediately to a growth in the deficit in the balance of payments current account and if it is not solved by the exchange rate channel, to inflation. Therefore in the actual period managed floating seems to be the most adequate exchange rate system for the SR. This system enables a step by step evaluation of the real exchange rate according to the Balassa-Samuelson effect and the stabilisation of the desired inflation rate supported by an adequate monetary and fiscal policy.

A floating exchange rate required lower costs and is better adapted to possible speculative capital attacks. This strategy has been applied by the NBS since 1998 as the credit transmission mechanism doesn't work ideally in Slovakia and exchange rate interventions can be a useful supplement of monetary policy. A higher inflation can be compensated by means of the exchange rate and so the country should have no problems to fix the inflation at the desired level. A problem, however, could be the ineffectiveness of domestic monetary and exchange rate instruments in the case of fully liberalised financial flows.

2. THE MONETARY POLICY IN THE TRANSFORMING COUNTRIES

Just in the beginning of the transformation from centrally planned to market economy economists agreed that a rational monetary policy aimed to stable monetary conditions is a necessary presupposition for successful realising this transition. Just in the beginning of the transformation process the institutional presuppositions for such a monetary policy were established by founding to a very high degree independent central banks.

All transforming countries were in the beginning of the transformation process faced with a deep crash after the disaster of the eastern block a high detained inflation and an irrational price system. Some countries solved this problem by a sudden liberalisation of the price system connected with a high growth in the price level (Poland, Czechoslovakia), other countries chose a step by step liberalisation of the price system (Hungary). At he same time monetary policy in these countries began to aim at a step by step lowering of the high inflation rate. The inflation rate. The inflation rate fell most rapidly in Czechoslovakia and its successor countries, the progress in Poland and Hungary was not so fast. Monetary policy in Czechoslovakia (later in Czechia and Slovakia) was oriented almost exclusively at lowering the inflation, where as in Poland it aimed – with some result – at influencing real economy in the desired direction.

The attitude of the different countries vis a vis the exchange rate was different, too. Czechoslovakia, and later Czechia and Slovakia, aimed up to 1997–1998 at preserving a fixed exchange rate as anchor of the monetary policy whereas the other countries from the very beginning preferred a floating exchange rate (Hungary at some time even realised a policy of permanently depreciating its own currency).

At present all analysed countries are aiming first of all at creating conditions for joining the European Monetary Union by approaching step by step to the Maastricht criteria.

Table 1

The development of the principal macroeconomic figures in some transforming countries

Year	HDP	Inflation rate	Unemployment	State budget balance	Balance of payments current account balance
1	2	3	4	5	6
POLAND					
1989	100,0	–	–	–	–
1990	88,4	585,8	6,3	–	–
1991	82,2	70,2	–	–	–
1992	84,3	43,0	13,6	–	–6,0
1993	87,5	35,3	16,4	– 2,7	– 2,8
1994	92,1	32,2	16,0	– 1,0	– 2,7
1995	98,6	27,8	14,9	– 1,8	– 2,4
1996	104,6	19,9	13,2	– 6,3	– 2,4
1997	111,8	14,9	10,3	– 3,2	– 1,2
1998	117,1	11,8	10,4	– 4,3	– 2,4
1999	121,8	7,3	13,1	– 7,4	– 2,0
2000	126,7	10,1	15,1	– 6,4	– 2,2
2001	128,0	5,5	17,5	– 3,4	– 4,3
2002	129,7	1,9	18,1	– 3,6	– 5,1
CZECH REPUBLIC					
1989	100,0	–	–	–	–
1990	98,8	9,78	0,7	–	–
1991	87,4	56,6	–	–	–
1992	84,6	11,1	2,6	–	+1,2
1993	85,1	20,8	3,5	1,3	+0,9
1994	87,4	10,0	3,2	– 2,0	+0,0
1995	92,9	9,1	2,9	– 2,7	+0,0
1996	96,6	8,8	3,5	– 7,6	+0,3
1997	96,9	8,5	5,2	– 6,1	– 1,2
1998	94,6	10,7	7,5	– 2,2	– 0,8
1999	95,1	2,1	9,4	– 2,7	– 0,6
2000	98,2	3,9	8,8	– 5,3	– 1,4
2001	101,4	4,7	8,9	– 5,7	– 1,4
2002	109,4	1,8	9,8	– 5,4	– 3,1
SLOVAKIA					
1989	100,0	–	–	–	–
1990	97,5	10,4	1,6	–	–
1991	83,3	61,2	–	–	–
1992	77,9	10,0	10,4	–	–
1993	75,0	23,2	14,4	– 6,2	– 5,0
1994	78,6	13,4	14,6	– 4,7	5,2

Table 1 (contd.)

1	2	3	4	5	6
SLOVAKIA					
1995	84,1	9,9	13,1	– 1,5	3,7
1996	89,6	5,8	12,8	– 4,1	– 10,4
1997	95,4	6,1	12,5	– 5,2	– 9,5
1998	99,6	8,3	15,6	– 2,5	– 9,4
1999	100,9	10,6	19,2	– 1,8	– 5,4
2000	103,1	12,0	17,9	– 3,0	– 3,6
2001	106,5	7,1	18,6	– 4,5	– 8,6
2002	111,2	3,3	17,5	– 4,8	– 8,2
HUNGARY					
1989	100,0	–	–	–	–
1990	96,5	28,9	1,9	–	–
1991	85,0	35,0	–	–	–
1992	82,3	23,0	9,8	–	+1,2
1993	80,4	22,5	11,9	– 8,9	+0,9
1994	82,7	18,8	10,7	– 9,4	+0,0
1995	84,0	28,2	10,2	– 5,4	+0,0
1996	85,1	23,6	9,9	– 3,9	+0,3
1997	89,0	18,3	8,7	– 2,0	
1998	93,5	14,3	7,8	– 5,0	
1999	97,4	10,0	7,0	– 5,1	
2000	102,5	9,8	6,4	– 6,2	
2001	106,4	9,2	5,7	– 3,4	
2002	109,9	5,3	5,8	– 4,0	
SLOVENIA					
1989	100,0	–	–	–	–
1990	91,9	549,7	4,7	–	–
1991	83,7	117,7	–	–	–
1992	79,1	207,3	13,7	–	+1,2
1993	81,3	32,3	13,4	1,5	+0,9
1994	85,6	19,8	14,2	3,8	+0,0
1995	89,2	12,6	14,5	– 0,2	+0,0
1996	92,3	9,7	14,4	0,3	+0,3
1997	96,5	9,1	14,8	0,2	– 1,2
1998	100,3	8,6	14,6	– 0,8	– 0,8
1999	105,5	6,6	13,0	– 33,9	– 0,6
2000	110,4	10,9	12,0	– 3,4	– 1,4
2001	113,7	9,4	11,8	– 0,4	– 1,4
2002	117,2	7,5	11,3	1,8	– 3,1

3. LIBERALISATION OF THE CAPITAL FLOW IN THE FIRST PHASE OF THE JOINING PROCESS

Another important demand in the first phase is to finish the process of capital liberalisation. Up to June 30^{th} 2002[1] 9 excluding Romania had finished joining negociations about chapter 4 – Free mobility of Capital. The process of liberalising capital flows in the Slovak Republic started Oct. 1^{st} 1995 when the crown became externally convertible. In this process direct investments were allowed, later indirect investments, financial loans, financial derivatives. real estate investments up to money flow and monetary accounts abroad. Liberalisation took place step by step from long term investments and financial loans up to short term ones and from relations to EU countries, EOCD up to global liberalisation.

The SR has achieved a remarkable liberalisation of capital flows. Foreign exchange operations were principally liberalised Oct. 10^{th} 1995 when the Foreign Exchange Act 202/1995 Z.z. came into force, which in accordance with Art. VIII of the International Monetary Fund contract liberalised all payments resulting from balance of payments current account. At the same time the circulation of Slovak crowns in foreign countries was made possible. Beginning with 1996 step by step further regulated capital transactions were liberalised by an amendment to the Foreign Exchange Act and supplementary regulations. At present inlanders can acquire foreign exchange and open foreign exchange accounts in domestic banks. Any limitations in giving financial loans to foreigners and receiving loans from foreigners were abolished, direct investments in OECD countries are possible, including investments in real estate, operations with foreign securities as well as the import and export of Slovak and foreign currency are allowed. Any limitation of export and import of Slovak and foreign currency was abolished.

The last ammendment to the Foreign Exchange Act 456/2002 up from 1.01.2003 liberalised operations with financial derivatives and abolished the possibility of limiting the export and import of bills and coins in cash in Slovak and foreign currency. As to capital flows this amendment made possible the opening of accounts abroad and investments abroad including investments in real estate in any territory. The term of liberalisation 1.01.2004 is in accordance with the obligation of the Slovak Republic against the OECD according the contract between the SR and the OECD from 28.9.2000 and the obligations accepted by the SR in 2001 in the negotiation process with the EU in chapter 4-Free Capital flow.

After Jan. 1^{st} 2004 there existed only limitations for the acquisition of domestic real estate by foreigners and these were abolished by the day of

[1] EU Enlargement Monitor Nr. 8, Deutsche Bank Research, June 2002.

Slovakia joining the European Union in accordance with the obligation accepted by the SR in the European joining contract between the European communities and the SR. The only exception is the acquirement of agricultural and forest estate where the Slovak Republic demanded a preliminary period of 7 years after having joined the EU.

4. THE FULFILMENT OF THE MAASTRICHT CRITERIA IN THE SR

The actual situation in the fulfilment of the Maastricht criteria is as follows:

- The inflation rate must not surpass the inflation reached in the three countries with lowest inflation by more than 1,5%.

The criterion of price stability is at present in the SR not fulfilled – the core inflation is at a level of 2,4%, but total inflation at the end of 2003 was 8,5%. It is supposed that inflation will continue to grow in consequence of price deregulation and liberalisation, tax reform, common agricultural policy in the EU and the Balassa-Samuelson effect. An inflation of 3% is expected in 2006.

- The state budget deficit must not surpass 3% of GDP. The fiscal deficit criterion is not fulfilled as in 2004 the deficit of the public budget reached 3,6% of GDP and the expected figures are 3,9% in 2006 and 3% in 2007.
- Gross state debt must not surpass 60% of GDP. This fiscal criterion is fulfilled by Slovakia as public debt in 2003 amounted to 41,8% and should reach the same amount in 2005, too (39,1% of GDP).
- Long term interest rates must not surpass the long term interest rate in the three countries with lowest inflation more than 2%. Long term credit rates for state bonds reached 8,5% in 2000 and 5% in 2003 which confirms the fulfilment of this criterion.
- The exchange rate has to stay in the EMS fluctuation zone at least 2 years before joining the EMU. The exchange rate of SKK against EUR has to be stabilised and its basic parity has to be fixed before SKK joins the exchange rate mechanism of ERM II. The parity will be fixed by the European Central Bank and ECOFIN. The National Bank of Slovakia was expecting a central parity of 43,62 SKK/EUR, so that +15% would be 50,16 SKK/EUR and – 15% 37,08 SKK/EUR. The exchange rate must not be devaluated within ERM II. At present the exchange rate against the EUR is fluctuating from + 5,9% up to 2,5%. In relation to the candidate countries within ERM II an oscillation zone of + – 2,25% will be expected (as in the case of Denmark).

Our analyse of how the SR is prepared to join the EMU shows that the Maastricht criteria could be fulfilled up to 2006. Opposite to these optimistic opinions there exist however also warning voices requesting a slower progress in introducing the euro and accepting a single monetary policy.

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TRANSFORMACJA KRAJÓW W DRODZE DO UNII MONETARNEJ

Artykuł prezentuje optymistyczny plan procesu przyłączenia Słowacji do EMU. Główny problem dotyczy pierwszej fazy procesu przyłączenia. Jest analizowany wybór odpowiedniego systemu kursu wymiany i polityki walutowej w tej przygotowawczej fazie. Dalej pokazano proces liberalizowania przepływu kapitału w Słowacji i obecną sytuację. Na zakończenie omówiono bieżące wypełnianie kryteriów z Maastricht i oczekiwania wobec wypełniania ich w przyszłości.