



Slovensko predsedstvo EU 2008
Slovenian Presidency of the EU 2008
La Présidence slovène de l'UE 2008

KEYNOTE SPEECH BY MINISTER BAJUK AT THE 3RD LUXEMBOURG FINANCIAL FORUM:

»Slovenia's First Experiences with the European Currency«

LUXEMBOURG, 30 MAY 2008 @ 14.30

Dear Ladies and Gentlemen, distinguished guests!

It is indeed an honour and a privilege to return to the Luxembourg Financial Forum and present to you our own national experience on a project that has demanded our permanent attention and efforts over the last 5 years and which in 2007 culminated in a successful adoption of the euro in Slovenia. This might be particularly important in these days as we are all celebrating the 10th anniversary of the decision to move to the third stage in the EMU and the 10th anniversary of our European Central Bank.

I believe most will agree that the enlargement of the euro area is a powerful instrument that is deepening further Europe's integration. When Slovenia adopted the euro as the 13th country – not an unlucky event, I hope – there were more EU Member States outside than inside the euro area. Further enlargements this year with Malta and Cyprus,

and a prospective entry of Slovakia are now shifting the balance. I cannot stress enough the importance of these developments, both in political and economic terms. We should be encouraged by this fact and advocate further enlargements of the euro area, of course, provided that the conditions and corresponding criteria are met in each particular case.

Let me now turn more specifically to the Slovenian experience of the euro adoption and the potential policy implications.

As you know, as far the adoption of the euro is concerned, Slovenia opted for the fast track approach. The Government and the Central Bank prepared a joint program already in November 2003, well before we entered the EU. The first question that arises is why the fast track approach. The reasons that were calling for a swift euro adoption were mainly three:

- Slovenia is a **small and very open economy**, with exports reaching some 70% of our GDP.
- About 2/3 of these exports are to the euro area and the same holds true for imports.
- And most importantly, we form an **optimal currency area** with the euro zone to the extent that our business cycles are synchronised, We have a similar economic structure and do not experience asymmetric shocks.

Quite frankly, this does not imply that there was anything wrong with our previous currency at the time, the tolar. To the contrary – it was a very

good currency which acted as a powerful stabilizer in the crucial years of transition. Today, almost everybody in Slovenia agrees that in the end we opted to change a good currency for an even better one, precisely due to the reasons outlined before.

The process of euro adoption formally started on May 1st 2004, when Slovenia entered the EU. It is important to note that in the latest EU enlargement rounds the new Member States did not have the so called “opt-out” possibility that the UK and Denmark got as far as monetary integration is concerned. We were all obliged to eventually adopt the euro, and Slovenia, as I said, decided to do it sooner rather than later. Of course, we were well aware that such a decision required a set of specific actions in two fronts and that in both we would have to get the things right with no delay: (i) prepare our economy so as to assure the fulfillment of the Maastricht criteria and (ii) start immediately with the practical preparations.

On the economic front, we joined the ERM II mechanism two months after EU accession. Participation in ERM II is a very important first step on the road to the euro. A smooth participation in ERM II is the essential testimony about the sustainability of the necessary convergence process prior to the adoption of the euro. The participation in ERM II ties the exchange rate and hence acts as a “testing phase” for the irrevocable exchange rate fixation. The benefits of a stable exchange anchor are obvious for every country that is planning to join a single currency area and particularly so, for those experiencing difficulties in achieving the level of sustainability required in their convergence towards all established criteria.

However, we quickly discovered that the mere joining ERM II was not sufficient by itself. We had to tighten our fiscal policy in order to gradually bring down the public deficit. **Inflation** proved to be the most demanding of the economic criteria to fulfil. To assure the convergence of our inflation levels with the requirements of the Treaty, we had to build a strong consensus among social partners to adopt a restrictive wage policy that was (and still is) a key factor that helped us reduce inflation. Since early 2004, our social partners agreed to a wage policy by which wages would increase by at least one percentage point below the expected growth in productivity. Slovenia managed to restrict wage growth below the growth in productivity, in some years by as much as 2 percentage points. This helped us maintain our competitiveness despite the fixed exchange rate regime. By keeping the course, we added credibility to our economic policy without which, market expectations would have driven us away and not closer to the euro area.

On the technical preparation side of the euro adoption project, we were in a way lucky. It was not that long ago that Slovenia changed currency from the Yugoslav dinar to the Slovenian tolar (1991). This meant that the vast majority of the population knew what an operation like this entails. At the same time, many of the policy makers in the central bank and the ministry of finance had been involved in the 1991 changeover. Nevertheless, we approached the preparations with all due diligence by also trying to incorporate experiences of others--the first group of entrants and those that followed.

In fact, the introduction of the new currency is a project that involves everybody: the state and its entire bureaucratic structure, the business community and the population at large. Well-informed consumers do play a key role in ensuring a smooth changeover.

In order to prevent undue price increases Slovenia introduced informative **double pricing** starting 10 months before the euro adoption which was maintained for six months after. We also set up a network of official **price-watchers**, while parallel price-watchers were organised by the Consumers' Association focusing on an assortment of key articles and services.

In addition, the government made the commitment not to use the changeover to increase fees and contributions determined by regulations and other legal instruments. All ministries and government departments were to honour the commitment and the private sector followed the example making similar commitments so that businesses would not round up prices.

In sum, the preparations were meticulous. But what really counts is the sentiment of the public. 95% of our population estimated that the changeover was successful, 92% felt well-informed. At the same time, 59% believed that the euro will lead to higher price increases (latest inflation expectations).

And this, Ladies and Gentlemen, turns me now to the consequences and the lessons of euro adoption in Slovenia.

First, the benefits. We know perfectly well that it is impossible to pinpoint the exact percentage of GDP increase due to euro adoption. What we do know is that Slovenia recorded a GDP growth rate of 5.7% in 2006 while the growth rate for 2007 was even higher – 6.1%. These are by far the most impressive results for our economy in the last decade. Even at the risk of falling in the logical mistake “post hoc, ergo propter hoc” since something happened after something else it must be due to it, I remain firmly convinced that such a growth would not have been achieved, without the stability and a new sense of normality that Slovenia experienced with the adoption of the euro, even recognizing the fact that all this happened during what were exceptional good years for the European and the world economy. Slovenia is an economy in the last phases of transition. The adoption of the euro meant for all something much more than a new stable currency. Above all it meant (and still does) the adoption of a set of rules whose observance is followed and supervised not only by domestic institutions. The euro acted as a breath of normality in our economic environment and like everywhere else, in Slovenia economic agents tend to respond positively to predictable circumstances. This is even more so in cases in which predictability and respect of the rules of the game is not perceived as present at the desired level.

On the other hand, we can not ignore the inflationary pressures we have experienced well into the post adoption period. Although EU as a whole experienced higher-than-expected inflation last year, the average 12 month inflation in Slovenia stood at 3.6%, and the Dec. on Dec. at 5.2% , the highest level in the euro group. Let me say it at the outset, that the introduction of the euro is not the cause of this. As a matter of fact, various analysis made have confirmed that no more than .3 percentage

points can be attributed to the euro adoption. So, if the euro is not the cause, where is it?

Food prices and the price of oil were the main causes. Slightly more than 80% of the increase is explained by these two items. Given Slovenian consumption patterns, the weights of food and oil prices in our CPI are much higher than the average in the euro area countries. In the case of oil, it is slightly more than double.

There can be little doubt that the difference in price increases in Slovenia and the Euro area average is a result of Slovenia's convergence with the more developed member states (Balassa-Samuelson effect). This is reflected in the economic growth that is twice as high in Slovenia than the average of the Euro area and was reflected in one percentage point higher inflation in Slovenia already at the beginning of 2007.

But where we did face adverse effects was the coincidence of euro adoption and external price shocks. As I mentioned before, double pricing was introduced 10 months before and concluded six months after adoption. Commitments made by the retail sector not to increase prices during euro adoption expired. At the same time, and as a reflection of rising world prices, businesses were faced with rising input costs. What they did was simply to wait for the commitments to end and compensate the increases thereafter. Possibly even overcompensate.

At the food price level, I believe it is important to note the lack of an adequate level of competition at the retail level has contributed to the unusually high level of food price increases experienced in Slovenia. For example, in 2007 processed food prices at the producer level increased

by 8.1% on the average in the euroarea countries, excluding Slovenia. At the retail level, the average increase was only 7% which suggests that retailers did absorb part of the increase by lowering their margins. In Slovenia we experienced the opposite. Not only the retailers did not reduce their margins: retail level prices of processed food increased 50% more than than at the producer level. Although the food retail chain has been fully privatized, it should be noticed that 80% of the market is dominated by three food chains.

Inflation does pose a challenge for the economic policy. I am quite happy to report that late last night after a 13 hour session in which the government presented adjustments to the 2008 general budget that will ensure a small surplus the second year in a row. The final vote will take place tonight and there are no reasons to expect that it will not be adopted as proposed. Let me just say, that fiscal policy is not to be found among the causes of inflation in Slovenia. Yet inflation remains as one of the biggest challenges we are facing. We are working seriously on the issues of competition at the retail level of the food chain, continuing the restrictive wage and fiscal policies and trying to anchor inflationary expectations. The latter, however, are not the easiest to cool down, the more so as we are faced with a heated pre-election period.

In conclusion, allow me to make a link to a remarkable anniversary we are celebrating this year, which will also be the point of discussion between Jean-Claude Juncker and Jurgen Stark immediately afterwards. 10 years ago, well before the launch of euro coins and banknotes, the euro was dubbed »An Awfully Big Adventure«, a convoluted, not so discreet way of conveying the ominous message that it was destined to die. There was considerable scepticism over how the European

economies would cope with a single monetary policy, the loss of exchange-rate flexibility, and what would happen when the EU next hits a downturn. The role of the ECB itself was questioned: the scepticism of national central banks giving up parts of their sovereignty or the fact that it was understaffed (500 staff in 1998 compared to Bundesbank 20,000).

This year, during the Slovenian Presidency of the EU, **the EMU and the ECB are celebrating their 10th anniversary**. We strongly believe the achievements over the decades are remarkable and on this basis we can look into the future and the challenges we are facing with justifiable optimism.

Ten years after moving to the third stage of EMU marks a good opportunity to assess its achievements and reflect on its future functioning. EMU has played a key role in accelerating economic integration in Europe and making Euro area countries more resilient to shocks. Macro-economic stability has markedly improved, and the Euro has become one of the leading global currencies. However, the Euro area Member States need to continue our efforts in adapting our economies and further increasing our adjustment capacity to shocks with a view to avoiding diverging trends in competitiveness. Tackling the Euro area's common challenges in a co-ordinated manner will provide further benefits, given the expected spillovers and interactions across euro area Member States.

As far as the more specific Slovenian euro adoption story is concerned, other countries that are at the preparatory stage may find useful to consider the following conclusions:

- when looking at the Slovenian model, understand the specific features which facilitated the changeover in Slovenia;
- as early as possible, convey the message about the extent to which a euro project involves all aspects of an organisation's activity and every type of entity, particularly all government departments;
- give the changeover team clear backing from the highest levels of government, appoint the best project managers, and ensure as much stability as possible to the whole project team;
- as early as possible, provide as much legal certainty on the details associated with introduction of the euro,
- pay particular attention to communication on price issues, in particular on communicating the reasons for price increases of specific items, and on good practices, such as fair-pricing agreements and the like.
- Last but not least, analyze the level of competition at the different segments of the market.

Slovenia's changeover from our tolar to euro was a swift and smooth operation. The fact that Slovenians were already familiar with next door neighbour currency also contributed to a rapid changeover process.

Today's discussions will certainly highlight the benefits that the euro has made possible in the past, but they will also highlight those areas where further efforts are needed to ensure the smooth functioning of the single currency. Nevertheless, one thing is certain; the enlargement of the euro area will increase the benefits of the single currency for all and such a policy certainly has and will continue to have Slovenia's full support.

Thank you!