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INTEGRATION PROCESS OF SLOVAKIA INTO THE EUROPEAN MONETARY UNION IN PERSPECTIVE OF SELECTED MACRO-ECONOMIC THEORIES DURING THE CURRENT ECONOMIC CRISIS

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ABSTRACT

Each national economy anticipates mostly positive effects after joining the Euro. Positive expectations are logical, since every new country admitted to the EU pledges to join the Monetary Union and till the admission has the status of a member state with a temporal exemption for the joining of the Euro. According to the macro-economic results, there is usually an illusion present that the membership in the Eurozone itself absorbs the progress of the global recession. On the other hand, in favor of the membership in the Eurozone speaks the fact that all countries admitted had to rigidly fulfill the Maastricht Convergence Criteria leading to the medium-term guarantee of a healthy and long-term sustainable economy.

JEL CLASSIFICATION & KEYWORDS

■ E50 ■ Currency ■ Euro ■ Eurozone

INTRODUCTION

The future of the national currencies of the European Union members is linked to the development of the European economy at present time. The single currency "Euro" (EUR) was introduced to world markets on January 1, 1999 and currently represents the main component of the Economic and Monetary Union (EMU) of the EU member states, the so-called Eurozone.

The single currency and Eurozone create many economic advantages for all economic subjects effective in member states of the EMU, but on the other hand, they represent considerable risks affecting macro-economic or micro-economic sphere. These risks are connected to the degree of preparedness of a new member to introduce the single currency and thus accept commitments arising from the membership in the Eurozone. The minimalization of these risks is assisted by the high level of convergence of the economy of the country to the economy of countries of the Eurozone (Lebiedzik, Tuleja, Pauhofová, 2008).

The admission to the EU pushed the question of forming of the basic monetary and exchange framework into the forefront of economic and political decision-making in the transitive economies. The question of admission of candidate countries to the EMU is closely related to the future formation of the basic framework to sustain the macro-economic stability. With a high capital mobility and significantly limited conditions of execution of an independent interest policy, the decision on joining the euro is connected to accounting for potential consequence of relinquishing of the flexible exchange rate as a stabilizing instrument, e.g. for absorption of macro-economic shocks (Mirdala, 2008).

The admission of Slovakia into the Exchange Rate Mechanism (ERM II) in the late 2005 was perceived rather positively. It was mostly positively received by bank analysts, members of the Club 500 and then government officials. Entrepreneurs anticipated mostly the elimination of exchange rate risks and costs connected to insurance thereof as well as the reduction of costs of currency conversion. However, there were voices that pointed out that the accelerated admission to the ERM II was motivated more politically than economically. When discussing the admission to the Euro in Slovakia, the discussions usually narrowed down to whether Slovakia fulfills convergence criteria. A little attention was paid to their sustainable fulfillment, a sound concept of the optimum conversion rate of the Slovak crown was absent, even the key issue of the actual convergence was pushed to the background (Okáli, Iša, 2008).

The outbreak of the economic crisis in the end of 2008 significantly affected Slovakia and facilitated the emergence of a legitimate question whether the situation would be different in certain European economies if they were or were not members of the EMU at that time. The answer is not universally applicable to all countries of the EU that have not joined the single currency.

A reliable answer has to take into consideration possible advantages as well as disadvantages of such admission to the Eurozone with subsequent specifications of the monetary policy and its impact on the economy.

The objective of this article is to evaluate the process of the Slovak Republic's admission to the European Monetary Union through macro-economic theories that opens the perspective to the problem of timing of the admission to the Eurozone and the problem of the impact of the decision on the direction of the economic policy of a national economy in the scope of the European Union.

Content-wise, this article depicts the process of the Slovak Republic's admission, individual advantages and disadvantages of this decision and restrictions following this decision for the national economy as a whole.

When to join the Euro

History shows that if the Slovak Republic wanted to join the single currency it had to fulfill the so-called Maastricht convergence criteria (the stability criterion, the long-term interest rate criterion, the public deficit criterion, the public debt criterion and national currency stability in the European Exchange Rate Mechanism ERMII criterion).

Concerning the joining of the single currency, the often-mentioned fact is the need to gain on the economic as well as price level of the developed member states of the EU prior to the admission to the Eurozone.

The economic level is the process of the actual convergence that is possible to acquire through a higher rate of the real GDP growth or the real valorization of the national currency, or the combination of both above-mentioned variables.

The price level is the process of the nominal convergence the country is possible to reach through two different methods, either through the nominal valorization of the national currency (the so called exchange rate channel) or through a higher inflation of the national economy (the so called inflation channel), or through combination of both above-mentioned variables.

The inflation targeting with the flexible exchange rate is considered according to L. Komárek et al. (2010) as the most suitable and safest monetary-political regime for rapidly converging countries. Since if the real appreciation of the currency is administered exclusively through the channel of the higher inflation it results in low real interest rates, growth of inner and outer imbalance, which further results in a higher vulnerability of such a country during the time of crisis or turbulence. Other economic policies are overextended or are unable to balance this disequilibrium.

Each national economy anticipates mostly positive effects after joining the Euro. Positive expectations are logical, since every new country admitted to the EU pledges to join the Monetary Union and till the admission has the status of a member state with a temporal exemption for the joining of the Euro.

Impacts of the Eurozone admission

Slovakia joined the single currency on January 1, 2009. The admission of the Slovak Republic to the European Monetary Union resulted in termination of the national currency – the Slovak crown, which in principle resulted in the termination of the autonomous monetary policy. The loss of the autonomous monetary policy is a cost of a country's admission to the Monetary Union.

The passing of the monetary sovereignty by the admission of the EMU does not necessarily result in a heightened risk of the negative impact of macro-economic shocks on the progress of the output. The use of flexible exchange rates as a stabilizing mechanism for the absorption of negative impacts of macro-economic shocks is presented as less effective in the research of R. Mirdala (2008).

It is important to state that the admission to the Union and joining of the single currency has its benefits. One of the significantly positive effects is the elimination of risks of the exchange rate towards the Eurozone countries, which usually results in decreased transactional costs and lessening of the investment insecurity; another positive effect is the stabilization of the long-term interest rates on the lowest level and the access to more liquid Eurozone markets; the next important advantage is the heightened stability of the financial sector and lessening of risks of monetary turbulence; at last and in my opinion the most valuable advantage is the requirement to fulfill the demand of the balanced public budget, which at present represents one of the most important problems of the Eurozone countries.

The admission to the Monetary Union will always be accompanied by advantages and disadvantages. What will prevail in the time of the economic crisis cannot be generalized for each and every member state of the European Union, only time will show what represents an advantage (assets) and disadvantage (costs) for the Slovak Republic.

The existence of the single currency anticipates the unified monetary policy which direction is determined by the European System of Central Banks implemented by the European Central Bank in Frankfurt on the Main. Since national central banks are only implementing the policy of the European Central Bank, they are unable to lower interest rates during the time of crisis (recession) or raise these rates as an attempt to prevent inflation. As a supranational authority, the European Central Bank has to consider broad and wide-ranging objectives of the Monetary Union, the most important objective from the perspective of a national economy is to synchronize the national economic cycle with objectives of main trade partners in the Eurozone.

In case of such synchronization on the highest possible level, there is a high probability that objectives of the national economy will not be in contrast with the monetary policy of the European Central Bank.

Restrictions and obstacles of monetary policies

In the time of the current economic crisis, central banks lower their interest rates in an unprecedented extent, indicated by historical minimums (USA the level of 0 – 0.25 per cent) trusting that such inexpensive finances will lead to a higher lending which should result in higher spending and investments.

Main aims of the monetary policy are conflicting in a sense that the accomplishment of one prevents the accomplishment of another objective. The effort for the price stability in the time of a rapid economic growth or in the time of the economic crisis (recession) elicits the so-called central bank dilemma. This dilemma consists of the decision-making process and whether it will follow the stability of the money offer (the interest rate has to change) or the stability of the interest rate (the money offer has to change).

On the other hand, politicians as well as economic subjects ascribe a massive emphasis on effects of the monetary policy that not always fulfills these expectations. Among basic but fundamental restrictions of the monetary policy belong:

- The control of the amount of money in the economy is not an easy task (the control is not as accurate and finite because of the free movement of finances across borders and a relatively easy conversion from one national currency to other).
- Effects of changes in the discount rates have only anticipated and not absolutely certain impact, this being influenced by either pessimistic expectations (negative influence of the lowered interest rate) or positive expectations (weakening of absorbing influence of the heightened interest rate).
- The increasing of the interest rate (in order to confront the inflation pressure) usually results in the widening of the interest differential which leads to influx of speculative capital from foreign countries that depreciates the effort of the central bank in a restrictive monetary policy.
- The decreasing of the interest rate in order to stimulate investments can lead to reflux of the capital to foreign countries that depreciates the effort of the central bank in an expansive monetary policy.
- The self-financing of investments by companies also contributes to the weakening of the monetary policy with large companies usually self-financing their investments – i.e. out of the undivided profit resulting in the part of economy spraining free from the immediate influence of the monetary policy (in Czech, as well as in the Slovak Republic this factor was not very important in the latter years since companies do not dispose of large amounts of capital).
- The influence of the monetary policy have almost always delayed impact on the real product and employment/unemployment in the economy (2-18 months), which is a strong argument against the use of monetary instruments in the anti-cyclic policy.

The failure of the monetary policy in the time of recession can be imputed on one of the most probable scenarios, this being the lowering of interest rates to such an extent that they become completely insensitive to heightening of the money supply which is in theory usually labeled as the so called "liquidity trap". In this situation, economic subjects are willing to sustain all finances until their real valorization or effective use. In such environment, the traditional expansive monetary policy is ineffective according to the economic theory.

In the last 30 years of the 20th century, the relatively strong position in the economic policy was held by monetarism. Currently, there is the view that precisely the effectively implemented monetarist experiment of the USA during 1979-1982 which main goal was to determine the stable growth of the money supply (the so called monetary rule) regardless of changeable conditions of economy undermined the very effectiveness of the monetarism in the future. The speed of money in circulation changed, thanks to the experiment, and became highly unstable till the point in the early 2000 when the Federal Reserve Fund in the USA ceased to implement "the monetary rule" for its monetary policy (since monetarism anticipates a constant level of speed of money circulation, which is unable to be ensured at present resulting in the shifting of the relatively compact theory into the sphere of dead ideas).

In spite of the above-mentioned restrictions, the monetary policy is in principle the primary instrument used in balancing economic cycles. The monetary policy uses other key macro-economic variables, e.g. the progress of real and nominal production (the real and nominal GDP), unemployment and the labor force indicator that significantly expose the state of the economy.

Conclusion

According to the macro-economic results, there is usually an illusion present that the membership in the Eurozone itself absorbs the progress of the global recession. The successfulness of the monetary policy in the solution of cyclic fluctuations of economy can encounter the above-mentioned restrictions and other obstacles whether it is the national central bank or the European Central Bank the one responsible for the monetary policy.

The admission to the Monetary Union will always be accompanied by discussions on advantages and disadvantages of such country's integration into the protection and monetary policy of the European Central Bank. What prevails in the time of the current economic crisis cannot be generalized and only time will show what formed an advantage (assets) and disadvantage (costs) for the Slovak Republic.

In favor of the membership in the Eurozone speaks the fact that all countries admitted had to rigidly fulfill the Maastricht Convergence Criteria leading to the medium-term guarantee of a healthy and long-term sustainable economy.

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